



Meeting: **Scrutiny Commission**

Date/Time: **Monday, 29 January 2024 at 10.00 am**

Location: **Sparkenhoe Committee Room, County Hall, Glenfield**

Contact: **Mrs J Twomey (Tel: 0116 305 2583)**

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Membership

Mr. M. T. Mullaney CC (Chairman)

Mr. T. Barkley CC Mrs. A. J. Hack CC
Mr. M. Frisby CC Mr. J. Morgan CC
Mrs. H. J. Fryer CC Mrs. R. Page CC
Mr. S. J. Galton CC Mr J. Poland CC
Mr. T. Gillard CC Mr. T. J. Richardson CC

AGENDA SUPPLEMENT

A supplementary report has now been published in respect of agenda item 12 as detailed below.

<u>Item</u>	<u>Report by</u>	
12. Draft Revised Investing in Leicestershire Programme Portfolio Management Strategy 2024 - 28	Director of Corporate Resources	(Pages 3 - 80)



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OVERVIEW AND SRCUTINY COMMITTEE – 29TH JANUARY 2024

DRAFT INVESTING IN LEICESTERSHIRE PROGRAMME PORTFOLIO MANAGEMENT STRATEGY 2024 TO 2028

SUPPLEMENTARY REPORT BY THE DIRECTOR OF CORPORATE RESOURCES

Purpose of the Report

1. The purpose of this supplementary report is to provide additional information relating the external review of the Investing in Leicestershire Programme portfolio including recommendations relating to future investment strategy to be adopted together with an assessment of the impact on the Programme.

Background

2. An external review of the portfolio's performance and strategy was undertaken by Hymans Robertson in December 2020 which made recommendations as to future investments going forward, to ensure financial resilience by maintaining a balanced diversified portfolio of assets. In accordance with the requirement that the portfolio's performance and strategy be reviewed at 3-yearly intervals Hymans Robertson were commissioned to undertake a further review in late 2023.

Hymans Robertson Review 2024

3. Following circulation of the report to Committee Members, the Hymans Robertson review has now been completed. A copy of the full review is appended to this supplementary report, as Appendix A. In light of this, the Strategy document has been further updated to reflect the review recommendations and a copy attached as Appendix B.
4. The 2024 Review, as with the earlier 2020 Review, considers the current economic outlook and that of the real estate investment market. Based on the make-up of the portfolio as at 31st March 2023 the current portfolio mix of approximately 67% direct property and 33% diversifiers is still considered appropriate and strikes a reasonable balance between the positive economic, social and environmental impacts generated in the direct portfolio and the downside protection provided by the diversifiers portfolio.

5. Given the volume of new investments to be made, it is anticipated that the direct portfolio will see only modest growth. It is therefore recommended that the Council explores opportunities to dispose of certain existing assets and recycle the capital into new developments. This will enable the Programme to maintain a high level of positive impact in the local community, as well as providing the opportunity to implement some of the portfolio refinements proposed below.
6. In addition, the Review acknowledges that the development sector, at 29% of the direct property portfolio, is currently significantly larger than would normally be anticipated. The disposal or future development of assets within the sector will correct the balance.
7. In considering the future direction of investment strategy the Review makes the following recommendations:
 - a. In respect of the Direct Property Portfolio
 - i. Increase the allocation to the Industrial/Logistics sectors
 - ii. Maintain or reduce the allocation to Offices
 - iii. Selectively consider Retail investments
 - iv. Maintain the Rural allocation
 - v. Increase the allocation to other Alternative sectors
 - vi. Cap the allocation to Residential

The review also considers that local infrastructure assets are potentially attractive additions to the Fund's direct portfolio, offering a good income yield, potential diversification and clear economic and environmental benefits.

- b. In respect of the Diversifiers
 - i. Allow the allocation to pooled Property to fall but ideally not below 25%
 - ii. Maintain the allocation to pooled Infrastructure
 - iii. Increase and diversify the allocation to pooled Private Debt
8. The review does not recommend any major changes of direction. However, it does suggest that within the direct portfolio consideration be given to selected retail investments and recognises the potential for investment in local infrastructure assets. In the case of diversifiers it advises that the portfolio be rebalanced reducing the level of pooled property and maintaining the level of pooled infrastructure investments whilst increasing and diversifying the portfolio of private debt investments.
9. It is proposed that the above advice be used to inform all future investment decisions, forming an integral part of all investment assessments which will continue to be supported by full business cases.

Appendices

Appendix A – Hymans Robertson Leicestershire County Council – Investing in Leicestershire Programme Strategy Review Paper

Appendix B – Draft Investing in Leicestershire Programme Portfolio Management Strategy 2024-28

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Leicestershire County Council – Investing in Leicestershire Programme

Strategy Review Paper

January 2024

Philip Pearson, Partner

With support from:

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For and on behalf of Hymans Robertson LLP

Contents

	Page
1 Introduction	1
2 UK Property Market Review	6
3 High-level Strategy	10
4 Portfolio Review	12
5 Strategic Proposals	20
6 Pooled fund exit options	28
Appendix A – Investment objectives, strategy and criteria	29
Appendix B – Infrastructure Market Review	32
Appendix C – Private Debt Market Review	34
Appendix D - Overview of current situation facing UK pooled funds	37

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1 Introduction

Addressee

This paper is addressed to Leicestershire County Council (“the Council”). It provides a strategic review of the Council’s Investing in Leicestershire Programme (“liLP” or the “Fund”)

We accept no liability where the report is used by, or released or otherwise disclosed to, a third party unless we have expressly accepted such liability in writing. Where this is permitted, the report may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

Please note the value of investments, and income from them, may fall as well as rise. You should not make any assumptions about the future performance of your investments based on information contained in this document. This includes equities, government or corporate bonds, currency, derivatives, property and other alternative investments, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the full amount originally invested. Past performance is not necessarily a guide to future performance.

Background

Investing in Leicestershire Programme (“liLP”) is a council-administered investment fund managed by Leicestershire County Council (the “Council”) for the benefit of local residents. The purpose of liLP is to generate income to support the delivery of front-line services, whilst contributing to the Council’s strategic objectives and the economic growth, social wellbeing and environmental sustainability of the county.

The aims of this Strategy have been aligned with the five Strategic Outcomes set out in the Council’s Strategic Plan (see Appendix A) which will play a key role, alongside the Medium-Term Financial Strategy (“MTFS”), in shaping the Council’s investment activities over the next four years.

The liLP portfolio currently comprises investments including current developments worth £233m¹ with a further c£55m earmarked for investment under the current MTFS. The portfolio generates a net annual income of £6.2m. Investments include a core portfolio of directly-held properties including Offices, Industrial and Residential properties and farmland primarily located in Leicestershire, and a portfolio of diversifying pooled investments in property, infrastructure and private debt. Direct property includes both investment and development assets. Diversifying investments are held in pooled funds managed by external investment managers. The portfolio is managed according to a consistent investment strategy, but the composition of the portfolio has evolved over time to include a larger allocation to direct property and diversifying (non-property) assets.

The Council manages the portfolio under general investment powers conferred by the Local Government Act 2003. Investments are made in accordance with guidelines set out in the CIPFA Prudential Code, and the Council also aims to comply with the Public Works Loan Board lending terms set out by HM Treasury. Key provisions include:

- Allows authorities to take higher risk with investments “held primarily for commercial purposes”² than would usually be the case in treasury management;
- Requires authorities to set a balance between security, liquidity and yield which reflects their own risk appetite, but does not set specific investment constraints in terms of eligible assets, portfolio concentration etc;

¹ As at March 2023

² Investments held primarily to generate a financial return

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- Prohibits authorities seeking to borrow from the PWLB from acquiring assets held primarily for commercial purposes;
- Existing investments acquired before June 2023 and held for commercial purposes, do not preclude access to the PWLB, but exit options must be considered;
- Allows authorities to borrow to invest in assets held primarily to support service delivery, policy objectives, housing, economic regeneration and treasury management;
- Requires authorities to prioritise security over liquidity, and liquidity over yield, when making investments for treasury management purposes. In particular, it is expected that such assets will offer a high level of principal protection and predictable liquidity which allows the cash position of the wider treasury portfolio to be managed prudently.

Our understanding is that the Council may seek to borrow from the PWLB, so must safeguard access to this facility. This has significant implications for liLP investment strategy which are summarised below, and referred to in the recommendations made elsewhere in this paper:

- No further commitments can be made to investments held for commercial purposes, either in the direct or diversifiers portfolio (but commitments can be made for treasury management purposes);
- Many of the direct properties are held for one or more of the eligible purposes listed above;
- Within the diversifiers portfolio, the pooled property and infrastructure investments are deemed to be held for commercial purposes, so no further commitments can be made. The pooled private debt funds offer a high degree of capital protection and predictable liquidity and are therefore considered to be treasury management assets;
- All the existing investments within the diversifiers portfolio were fully committed before June 2023, so should not preclude access to the PWLB and there is no requirement to liquidate them (although we do consider exit options);
- The investments within the diversifiers portfolio diversify the risks associated with the direct property portfolio, either geographically or by asset class or both, so we would recommend retaining the majority of the existing diversifying portfolio. Fully replacing the diversifying portfolio with directly held properties located in Leicestershire would materially increase the overall risk profile;
- If circumstances change and it becomes possible to make further commitments to investments held for commercial purposes, we have recommended a number of changes to portfolio composition which we believe should be considered.

Conclusions and recommendations

The main findings of our review are as follows:

- The objectives, target return and investment strategy are appropriate given the aims of the Fund and current portfolio composition;
- We are broadly comfortable with the composition of the portfolio, subject to some refinements below. In particular, we are comfortable with the mix of directly-held assets and diversifying investments held in pooled funds. We are also comfortable with the relatively high level of development projects given the Fund's twin objectives of generating a financial return and having a positive local impact;
- The performance of the direct property portfolio has been relatively strong in difficult market conditions. Key property indicators are consistent with, or ahead of, the market for good quality secondary properties located outside major metropolitan areas;
- By contrast, the performance of the diversifiers portfolio has been mixed particularly in recent years. Four of the five pooled Property funds have underperformed. The pooled Corporate Lending funds are

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performing in line with expectations, whilst the pooled Infrastructure and Bank Risk Transfer funds have performed well;

- Looking forward, we believe the portfolio has the potential to deliver the target return.

In the light of these findings, we make the following key recommendations in relation to the direct portfolio:

- Set ranges/limits on exposure to individual assets, tenants, sectors and asset classes in order to guide the development of the portfolio;
- Adjust the allocations to individual sectors as detailed in the table below, limiting the exposure to Residential to 15% of the direct portfolio over the long-term;
- Explore opportunities to dispose of selected properties, partly to implement the new allocations, partly to reduce the asset management costs associated with smaller assets and partly to recycle capital into further new developments thereby maintaining the level of impact delivered by the portfolio;
- Consider local infrastructure and corporate lending opportunities, to be developed in partnership with specialist investment managers (subject to consideration of ease of implementation and potential for financial returns which are consistent with the Fund's objectives);
- Regularly review the refurbishment plans and associated capex requirements of directly-held properties, particularly in the context of the Net Zero objective and prospective environmental legislation;
- Recognising that the economic and social impacts of the Fund's developments are likely to be greater if they are intentional and measurable, consider putting in place systems to measure and track the impacts achieved and consider setting targets in key impact areas.

In relation to the diversifiers portfolio, we recommend:

- Allowing the allocation to Property pooled funds to fall as closed-ended funds pay back capital, but ideally and if possible not below 25% of the diversifiers allocation in order to maintain adequate diversification;
- Undertake due diligence on the combined Lothbury and UBS Triton investment proposition, and merger terms once details are available, and then consider whether or not to remain invested;
- Maintain the allocation to Infrastructure pooled funds at 10-15% of the diversifiers allocation;
- Increase the allocation to Private Debt pooled funds, but consider opportunities to diversify the exposure including real asset-backed senior debt, trade finance and short-dated, listed credit;
- Add a second Corporate Lending manager in order to diversify manager risk;
- Recycle the capital released by the Bank Risk Transfer fund (CRF V) into other areas, noting that a small weighting to this asset class is appropriate given the higher risk of capital loss;

Finally, in relation to the overall portfolio, we recommend the Council undertakes further work to identify what additional actions need to be taken to deliver the net zero objective.

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The table below summarises our recommendations across the portfolio:

Asset Class	Value at 31 March 2023 (million)	% of Total Fund	Strategic Recommendation
Offices	£53.1m	22.7%	Maintain or reduce
Industrials	£29.3m	12.6%	Increase
Distribution	£0.6m	0.3%	Increase
Retail	£0m	0.0%	Selectively introduce
Rural	£24.2m	10.4%	Maintain
Other	£4.6m	2.0%	Cap Residential Increase other Alternatives
Direct Portfolio (exc. Dev.)	£111.8m	47.9%	
Development	£46.2m	19.8%	Maintain
Direct Portfolio (inc. Dev.)	£158.0m	67.7%	
Property	£22.5m	9.6%	Maintain where possible
Private Debt	£44.2m	19.0%	Increase and diversify; allow bank risk share to reduce
Infrastructure	£8.7m	3.7%	Maintain
Pooled Fund Portfolio	£75.4m	32.3%	
Total	£233.4m	100.0%	

Next steps

We recommend the following next steps, in a broad priority order:

1. Confirm the eligibility of the proposed diversifying investments under PWLB lending criteria;
2. Commission work to set guidelines on portfolio composition and to consider establishing impact tracking systems in respect of the direct property portfolio;
3. Review the direct property portfolio to identify potential disposals and ensure adequate refurbishment plans and associated capex provisions are in place;
4. Explore the potential for local infrastructure and corporate lending investments with specialist investment managers active in this area, including the Fund's own pooled fund managers;
5. Review the terms of the proposed merger between the Lothbury Property Trust and the UBS Triton fund with a view to remaining invested if the terms are acceptable;

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6. Evaluate the investment case for diversifying the Private Debt portfolio into real asset-backed senior debt, trade finance and/or short-dated, listed credit
7. Commission further work to identify what additional actions need to be taken to deliver the net zero objective.

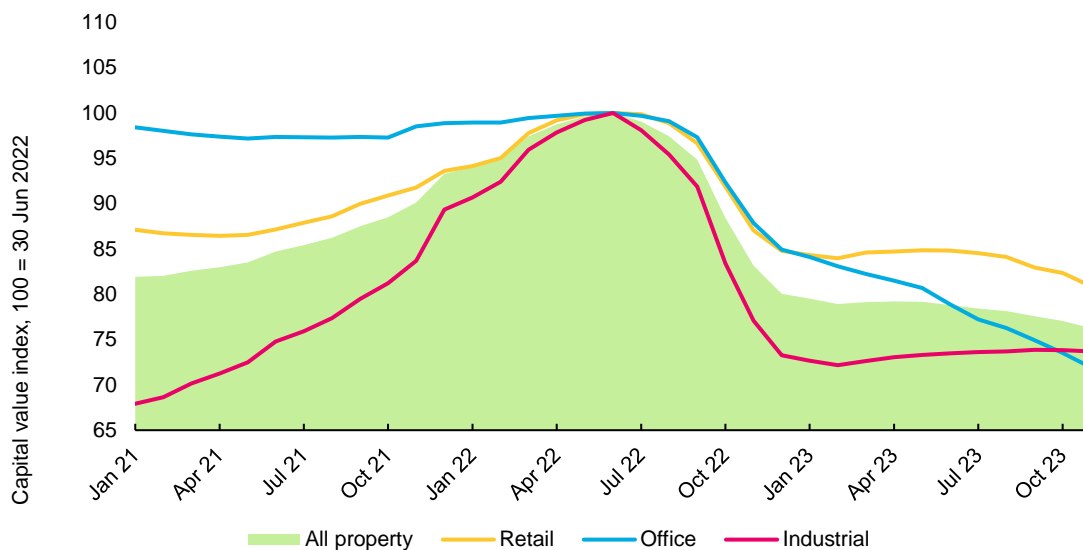
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2 UK Property Market Review

Capital values

The UK property market reached a peak in the middle of 2022 following a period of capital values rising by 22% over 18 months. Capital values have since been declining, falling by 23.7% from June 2022 to November 2023.

Chart 1: UK commercial property sector change in capital values January 2021 – November 2023



Source: MSCI November 2023

Capital declines have occurred across the three main commercial property sectors:

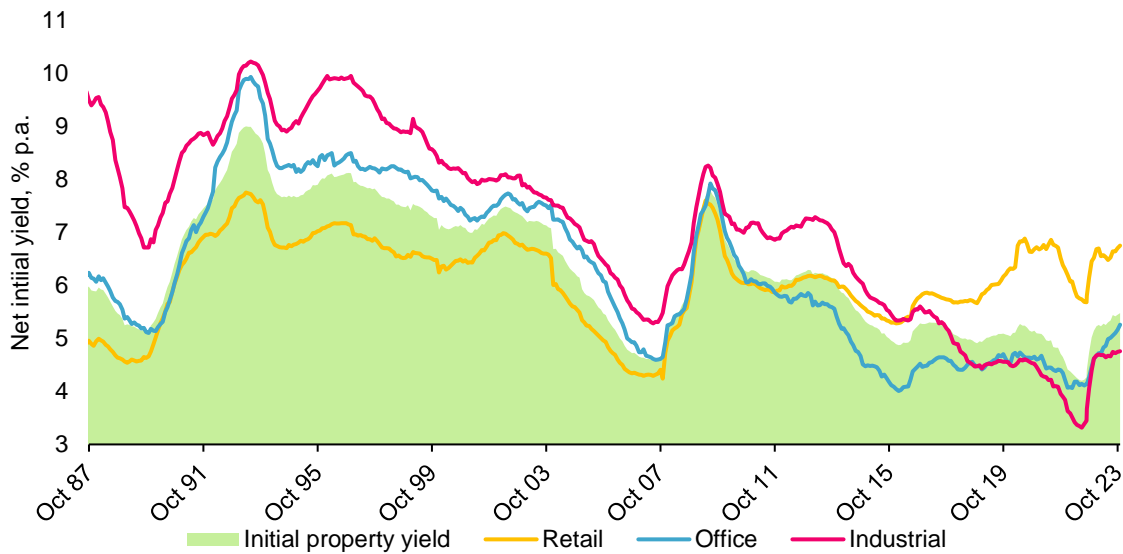
- The Industrial sector experienced a sharp correction over the second half of 2022. Prior large increases in capital values had pushed income yields to very low levels, leaving the sector particularly vulnerable to repricing from higher gilt yields and risk premiums. Values started to recover from March through to September 2023. However further marginal declines were experienced in the sector in October and November 2023.
- Values in the office sector didn't fall as quickly but continue to experience significant capital falls on a monthly basis.
- In the Retail sector, there was a hint of stabilisation with some capital growth, in particular from the Retail warehouse sub-sector over three months from March to May 2023 but this wasn't sustained as further declines were experienced during the following six months to end November 2023.

Yields

Property yields have been rising since the market peak in the middle of 2022. The initial yield on the MSCI Monthly index has expanded from 4.2% to 5.5% over the 18-month period to the end November 2023. Higher yields are a response to higher base interest rates and the greater quantity of property coming onto the market to be sold.

Although yields have risen, they were coming off a historically low base at the peak of the market and reported yields from MSCI are still below their long-term averages (historic average initial yield is 6.3%). However, transaction volumes have been very low since the third quarter of 2022 and reported yields from MSCI may not be fully reflective of the yield that could be attained in the transaction market.

Chart 2: Property yields by sector since 1987



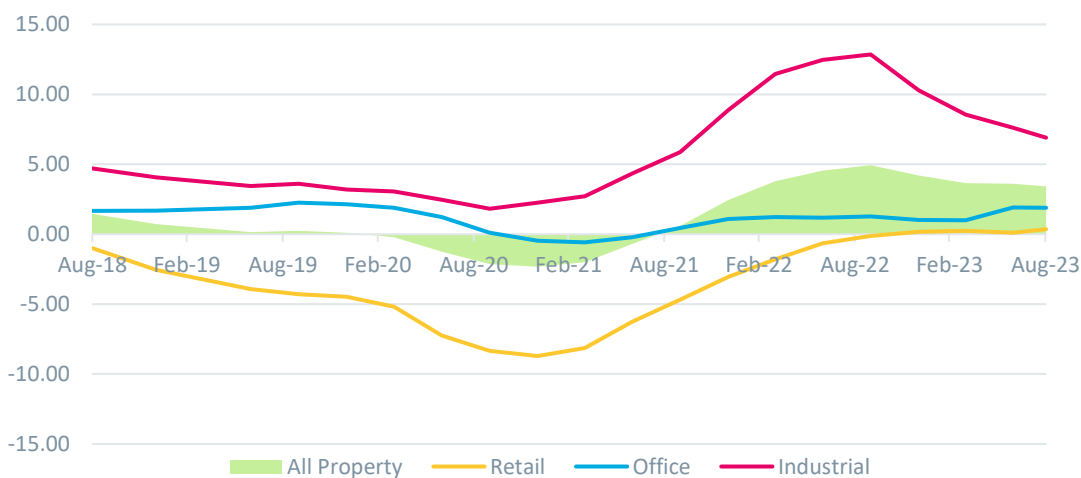
Source: MSCI March 2023

Rental Growth

Property rents have not been keeping pace with inflation in the recent high inflationary environment. Nominal rents have been rising since March 2021, with annualised growth reaching its peak in August 2022 at c.5% p.a. This is reasonable relative to the long-term historic comparison but is low in real terms given the elevated levels of inflation. While inflation rates have been coming down, the growth in nominal rents has been easing in recent months too.

Rental growth has been strongest in the Industrial sector in recent years due to structural undersupply that has provided ongoing support for the sector. Annual rental growth in the Industrial sector peaked at 13.2% nominal in August 2022; the rate of growth has been declining since then but remained at a healthy 7.4% nominal in the year to end November 2023. At the same time, the office sector rental growth is now at 2.1% on an annualised basis, this is the highest rate of growth since the start of the COVID pandemic. Rental growth in the Retail sector was 0.6% over the 12-month period. This follows over four years of annualised rental declines in the Retail sector.

Chart 3: Property rental growth over a 5-year period



Source: MSCI March 2023

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Rents tend to lag the economic and financial cycle and rely on tenants having confidence for the future in committing to additional or new space. Supply and demand dynamics rely on the future prospects of the wider economy, but local factors are also important.

The aggregate vacancy rate across the three commercial sectors has been gradually rising, mainly due to increasing office vacancies, and was 10% at end November. This is high relative to history (long-term average around 8%) and will continue to weigh on rental growth in the under-occupied parts of the market.

The office sector has suffered most acutely from shifts in working patterns following the COVID-19 pandemic, with tenants questioning the requirements of their office space. This is reflected in the vacancy rate of the office sector, rising from around 13% in March 2020 to 21% at the end of November 2023. The vacancy rates of the Industrial and Retail sectors are much lower, with MSCI currently recording rates between 6-7%.

Transactions market

The UK property market has been dominated by motivated sellers in the past 18 months. At the same time there has been a distinct lack of buyers. Investor demand for commercial property from leveraged buyers largely disappeared as the cost of debt increased. Transaction activities dried up in the second half of 2022 as a result which made price discovery difficult. More transactions took place throughout 2023 following significant price adjustments, but transaction volumes remain at low levels. This would indicate that further falls are required to attract more buyers back to the UK property market. The quality of properties has been extremely important as well as asset size (generally speaking, smaller transactions are proving more liquid).

Outlook

We expect that there is likely some further repricing to come through as more selling continues to be required to meet outstanding investor redemption requests.

Tenant and investor demand for more energy efficient properties will increase the obsolescence risk of some assets, placing additional pressure on valuations. We believe there is an increasing possibility of bifurcation between those assets that meet current and future environmental standards versus those that do not. In the office sector, we expect further capital declines, but the highest quality Offices in strong locations to be better insulated. Better quality assets (both from an environmental point of view and longer, secure leases) are more attractive to buyers and are experiencing greater liquidity and superior rental prospects.

There will be potential opportunities for long-term institutional investors to access the property market at more attractive yields and potentially at a discount to current market values. Higher construction costs are delaying new stock coming to market, which supports the occupational market for existing stock in the short-term. However, the latest RICS UK Commercial Property monitor survey showed a fall in occupier demand and rent expectations and an increase in supply as availability across Industrials and Offices continues to rise. Affordability is expected to become more of an issue for tenants. This, combined with reduced space requirements, mainly due to working from home and e-commerce, feeds into lower rental growth expectations going forward.

Energy efficiency and other ESG considerations are firmly on the agenda in major real estate markets. Savills estimated that real estate is responsible for almost 40% of energy and process-related emissions globally. The global transition away from fossil fuels and towards a low-carbon economy therefore has significant impact on buildings. Asset managers predict that it will become almost impossible to sell buildings that aren't energy efficient, which will require further investment to bring them up to standard. Many tenants and investors seek more energy efficient buildings as they can operate more efficiently, lower emissions and potentially lower the cost of capital.

A good proportion of commercial property (across all sectors) in the UK will therefore require significant upgrade to be fit for purpose as our economy transitions to net zero. This has the potential to impact returns both in the short term – if capital expenditure is required to fund upgrades – but also in the longer term. If buildings are left as they are, many could struggle to attract tenants and eventually become more difficult to sell and ultimately

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become obsolete. Fund managers tend to be careful in planning such expenditure to coincide with asset management initiatives that would have been happening in any case as part of normal asset annual business plans to minimise incremental spend.

Other asset classes

We provide a market overview for Infrastructure and Private Debt in Appendix B and C. We also provide a summary of the current challenges facing UK pooled property funds in Appendix D.

3 High-level Strategy

Appendix A summarises the investment objectives, strategy and criteria currently employed in managing the liLP fund, based on our understanding of existing documents³. We comment below.

Investment objectives

Target return

The overall target return is 7% p.a. net of expenses. No specific target has been set for income generation, but significant importance is attached to the certainty of income. We believe this is an appropriate target over the economic cycle, given both the aims of liLP and the current composition of the portfolio.

Income generation in commercial real estate is commonly affected by unforeseen capital expenditure requirements. The high likelihood of further environmental legislation to deal with climate change and the biodiversity crisis increases the risk of further investment being required. We recommend the Council regularly reviews the refurbishment plans and associated capex requirements of the direct property portfolio, particularly in the context of the Net Zero objective (see below).

Local impact and net zero

We note the objective to support a wide range of economic, social and environmental policy objectives. The current portfolio focuses on directly held properties in Leicestershire with diversifying investments in real estate, private debt and infrastructure worldwide. Going forward, there may well also be opportunities to focus on corporate lending and infrastructure projects in and around Leicestershire likely via direct investment.

Real estate and infrastructure, in particular, play a significant role in society, so well targeted investments in these areas can have a material economic, social and environmental impact. In our experience, these impacts tend to be greater if they meet the three criteria of additionality, intentionality and measurability. We recommend the Council puts in place systems to measure and track the incremental impacts achieved and considers setting targets in key impact areas. The Council should consider whether it has the necessary internal capabilities in this respect.

We are aware that the Council has a current objective to be net zero on a Scope 1 and 2 basis, and we understand the liLP strategy is aligned with this objective. It should be possible to deliver meaningful reductions in Scope 1 and 2 GHG emissions from the direct property portfolio between now and the target date, but achieving net zero on this basis will still be challenging. Investment managers in the diversifiers portfolio have softer objectives; two of the pooled property fund managers (Hermes and Threadneedle) are working towards net zero targets of 2035 and 2040 for their respective funds and have set out journey plans in order to meet these targets. We recommend the Council undertakes further work to identify what additional actions need to be taken to deliver the net zero objective across the liLP portfolio.

Investment strategy

We believe the high-level strategy outlined in Appendix A is appropriate given the purpose and objectives of the fund.

Within the property portfolio the aims have been to increase the proportion of investments held directly, to reduce tenant concentration (which should also occur as the liLP programme is expanded to its authorised limit of £260m) and to diversify across a wider range of property types, and we are supportive of these aims. We recognise that these may be competing objectives, as an increase to directly held properties would mean a decrease in the more widely diversified pooled fund holdings. This is taken into account in our proposals below.

We note the use of Treasury Management investments to diversify the portfolio and understand these include asset classes which offer a high level of principal capital security and predictable liquidity, and where income

³ Investing in Leicestershire Programme, Portfolio Management Strategy 2023/27

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accounts for a high proportion of total return. In that context, we recommend the Council also considers secured lending against property and infrastructure assets rather than always holding the equity, as this would improve both capital security and liquidity. Providing any such investments can be considered to be Treasury Management investments under the PWLB lending criteria.

Investment criteria

We are broadly comfortable with the investment criteria set out in Appendix A, given that the primary purpose of the fund is to deliver a positive impact as well as a financial return, and subject to the following observations:

- Liquidity – realistic expectations here are critical as the portfolio is inherently illiquid and would likely take many months and/or significant discounts to net asset value to fully liquidate the portfolio.
- Environmental sustainability – the requirement is to meet current/prospective sustainability requirements, but it may be appropriate to agree a specific set of sustainability standards so as to ensure the portfolio is appropriately future proofed.
- Portfolio fit – this is an important consideration when constructing a well diversified portfolio and avoiding excessive concentrations of risk. We recommend the Council considers setting ranges/limits on exposure to individual assets, tenants, sectors, asset classes and development projects in order to guide the future development of the direct portfolio. The guidelines should reflect the aims and composition of the portfolio and the characteristics of the local market, so it would be premature to be specific at this stage, but as an example, a limit of 10% of total rental income could be set for exposure to any one tenant.

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4 Portfolio Review

The table below summarises the Fund's portfolio as at 31 March 2023 with return calculations based on the annual reports over the last years:

Asset Class	Value at 31-Mar-23 (million)	% of Total Fund	Net Income Return (1 Year)	Capital Return (1 Year)	Net Income Return (3 Y p.a.)*	Capital Return (3 Year p.a.)**
Offices	£53.1m	22.7%	5.9%	-7.6%	4.7%	0.8%
Industrials	£29.3m	12.6%	4.7%	8.1%	4.8%	6.7%
Distribution	£0.6m	0.3%	-	-	-	-
Rural	£24.2m	10.4%	-0.1%	25.8%	-1.7%	16.1%
Other	£4.6m	2.0%	5.3%	-2.4%	4.9%	2.2%
Direct Portfolio (exc. Dev.)	£111.8m	47.9%	4.2%	2.5%	3.7%	5.3%
Development	£46.2m	19.8%	-0.5%	25.2%	-0.4%	9.0%
Direct Portfolio (inc. Dev.)***	£158.0m	67.7%	3.0%	9.1%	2.7%	6.7%
Property	£22.5m	9.6%	3.4%	-19.8%	3.4%	-3.3%
Private Debt	£28.7m	12.3%	0.9%	4.4%	4.8%	0.7%
Infrastructure ****	£8.7m	3.7%	n/a	n/a	n/a	n/a
Bank Risk Share ****	£15.5m	6.7%	n/a	n/a	n/a	n/a
Pooled Fund Portfolio	£75.4m	32.3%				
Total	£233.4m	100.0%				

Source: lILP / Corporate Asset Investment Fund Annual Reports. 3 year returns calculations assume income is reinvested, and in the case of income returns assume.

* based on geometric average of annual returns, assuming a steady capital value

** based on geometric average of annual returns, assuming income re-invested

*** approximately derived from Direct Portfolio (exc. Dev.) and Development figures

**** Initial investments into both of these funds occurred towards the end of 2022

We are aware that there has been a further commitment of £10m to Partners MAC VII that will see the value of the Fund's Private Debt holding grow in the near future. Also the pooled property fund run by Lothbury is in the process of liquidation, although the manager has received a proposal from UBS to merge the remaining the remaining portfolio into its Triton pooled property fund.

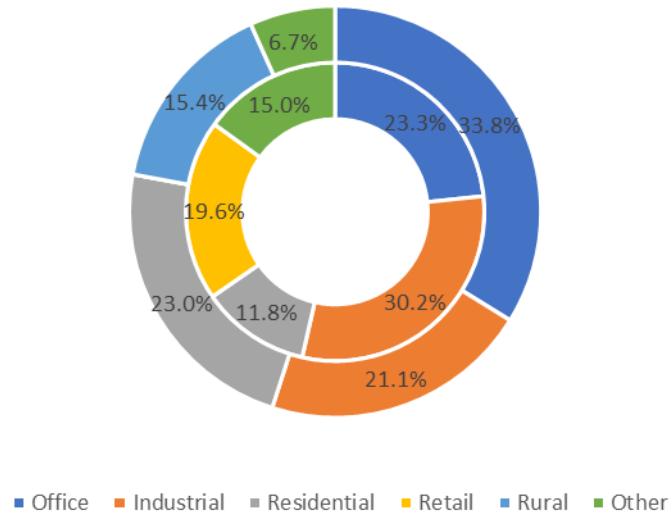
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We now provide comments on the assessment of the direct and pooled fund portfolios.

Direct Portfolio

The chart below shows the sector split of the UK wide MSCI Annual Property Index as at December 2022, which we believe is the best comparable with the Fund's portfolio.

Chart 4: MSCI UK Annual Property Index sector split (inner) vs Fund Direct Property (inc Development*; outer)



Source: MSCI. * Development sectors are not known in all cases so assumptions made. We have also assumed for the purposes of this chart that all development investments will be retained (or reinvested in similar sectors) however we understand this may not be the case over the longer-term.

We note that the Fund is overweight Offices, Residential and Rural relative to the wider market. The portfolio is underweight Industrials and other Alternatives and does not hold any allocation to the Retail sector, which makes up a material proportion of the wider market. Portfolio composition may well reflect the mix of opportunities in the Leicestershire, but it does mean that the Fund will have avoided the poor returns suffered by Retail and missed out on some of the strong returns delivered by Industrial.

The table below sets out some key performance indicators ("KPIs") for the direct properties (excluding Development).

Sector	Occupancy	Rent per sq ft (or per ha for Rural)	WAULT (years)
Office	92%	£17.43	6.77
Industrial	95%	£6.08	1.87
Rural	88%	£154.26	6.04
Other	100%	£4.47	4.55

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Offices

Over the three years to 31 March 2023, the Fund's office holdings provided a modestly positive capital return and a relatively healthy net income return. This is relatively strong given the difficult market environment for offices generally. The office property KPIs are consistent with good quality secondary properties located outside major metropolitan areas, and the vacancy rate (at 8%) is significantly lower than the UK market overall in which office vacancy rates have risen above 20%. However, we note significant tenant concentration risk within the office portfolio with the largest tenant accounting for 22% of total rent, and would suggest considering options to reduce that exposure.

Industrials

The Industrial holdings were amongst the stronger performers over the period, both in terms of income return and capital growth. This compares well with the wider market which has seen significant volatility over the last 3 years, after a period of very strong performance. The industrial property KPIs are again consistent with the wider market. The average remaining lease term is much lower than for Offices, but that is to be expected from this sector.

Rural

The Rural holdings continued to provide very strong capital growth. We have limited insight into the wider Rural market and the specifics of the assets owned by the Fund, but we note the yield is lower than that generated by commercial property assets generally and net of expenses is dilutive from an income perspective at portfolio level. However, the rural holdings do provide a stable "safe haven" for investors when other areas of the market are turbulent.

Currently, the rural holdings have a lower occupancy rate than would normally be expected and below that of the commercial sectors. This is due to significant areas of land being held in hand (albeit occupied on licence) pending disposal as part of strategic development opportunities coupled with the need to upgrade infrastructure on other holdings in advance of reletting. The other property KPIs are in line with expectations.

Development

The Development portfolio has delivered strong capital appreciation, but no material income yield, as we would expect. It is hard to benchmark the level of capital appreciation or the property KPIs without further details of the underlying projects.

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Pooled Property Fund Portfolio

The fund has five pooled property fund investments. The table below shows the net performance of each fund (with the exception of DTZ where we have only been supplied with performance gross of fees) over the trailing periods to 30 September 2023 (latest available, unless indicated) shown below alongside two representative UK property indices:

	Value at 31 March 2023 (million)	Hymans Rating	1 Year	3 Years (% p.a.)	5 Years (% p.a.)	Since inception (% p.a.)
DTZ (ex-Aegon) UK Active Value I	£3.8m	[redacted]	-15.5%	2.2%	1.3	5.1%
DTZ (ex-Aegon) UK Active Value II		[redacted]	-16.7%	0.5%	1.1	2.2%*
Federated Hermes Property Unit Trust	£7.6m	[redacted]	-14.5%	2.6%	1.7%	7.2%
Lothbury Property Trust	£6.5m	[redacted]	-21.3%	-1.6%	-1.5%	4.4%
Threadneedle Property Unit Trust	£4.6m	[redacted]	-12.8%	3.5%	2.0%	6.3%
MSCI AREF UK All Balanced Property Fund Index		-	-14.3%	3.2%	1.8%	6.0%
MSCI UK Monthly Property Index**		-	-13.6%	3.6%	2.2%	6.8%

Source: MSCI.

*Active Value II has not been running for 10 years, we have shown performance since inception in the 10 year column. Active Value I's 10 year performance is the same as since inception.

**Note the two MSCI indices shown differ as the Balanced Fund Index is a peer group index and return figures include the impact of indirect holdings, debt, management fees, tax and cash, while the UK Monthly Index is a direct property index computed at the building level and exclude these impacts.

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We provide comments on each fund holding below:

UK Active Value Property Funds I and II

- Both unit trusts are closed-ended. At outset, both funds had a value focus, investing in higher yielding UK commercial property.
- Active Value I launched in 2013 to invest in higher yielding, smaller lot size commercial property in the UK at attractive spreads in the wake of the Global Financial Crisis. The portfolio has broadly a third in each of the 3 main commercial property sectors, meaning it is underweight Industrial property and overweight Offices and Retail.
- Active Value Unit Trust II launched in 2016 and has a higher allocation to Industrials (44%), the fund's largest single sector allocation. It also has significant allocations to Offices and Retail warehouses (around 26% and 22% respectively).
- The funds were just about performing in line with the lower end of their target IRR ranges prior to the market correction in the middle of 2022. Both funds are now underperforming and unlikely to reach target IRR. Active Value I has a large office weighting, which is likely leading to some pain with office valuations continuing to decline. Active Value II is suffering from at least 2 tenants entering administration and the portfolio's vacancy level (expected to rise towards 20%) will continue to have a negative impact on performance.
- Despite the difficult market environment, the funds have benefitted from some good asset management initiatives and continue to experience some rental growth through tenants renewing leases.
- Both unit trusts are now in wind down mode. We understand that the management of the Active Value strategies has transitioned from Aegon to DTZ for the wind down phase.
- DTZ has been progressing sales but it has been a challenging market and they have received weak demand for those assets that have been marketed over the last year or so. This has resulted in a delay to the sales programme which will continue through 2024 and 2025.

Federated Hermes Property Unit Trust

- FHPUT was a strong relative performer for many years, a result of successful asset management initiatives and strong stock selection consistently adding incremental value over the longer term. However, relative performance has been negatively impacted over the last 3 years by FHPUT's underweight Industrials position and overweight position to the leisure sector. The latest distribution yield as at end September was 3.8%. The fund is well balanced across the main sectors. Hermes takes a very bottom-up approach so targets high quality assets located in areas with strong fundamentals. Many assets have been selected (or held) to drive value from potential alternative use (such as Residential). Federated Hermes usually has a small portion of the portfolio in value-add or more opportunistic strategies in order to generate higher returns over time. These asset management initiatives are timed to avoid taking too much risk at once and to take advantage of opportunities when they arise. The fund experienced some turnover in the team a few years ago but this has settled down over the last couple of years. FHPUT hasn't been immune from the redemption pressures facing core, balanced property funds over the last 18 months. It was getting towards the end of paying out all outstanding redemptions requests at the end of 2023 when a new request for £70m was received. We expect that this will be paid out over the next quarter or so.

Lothbury Property Unit Trust

- In May last year we were informed that Simon Radford and Jo Bond would be leaving Lothbury Investment Management. This sparked a run on the fund with almost all unitholders submitting redemption requests before the end of June 2023. The fund is now in wind-up mode although another fund manager, UBS, is preparing to put an offer to investors to take over the management of the fund,

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merging the remaining assets in the fund with its UK balanced fund, UBS Triton. We should have more clarity on this potential offer in the coming weeks.

- LPT is now materially underperforming. LPT focused on prime UK property assets and was a strong performer for many years. However performance started to dip around 2018 and really suffered during and following the COVID pandemic, largely due to its overweight Retail position that the Lothbury team took too long to reposition. The lower yielding nature of the portfolio made it more vulnerable to the market correction from higher gilt yields and risk premiums. The substantial redemption pressure has only exacerbated the underperformance of LPT in recent months. The latest distribution yield as at end September was 3.5%.

Threadneedle Property Unit Trust

- TPUT experienced a change in Fund Manager back in 2020 following the retirement of the previous fund manager and many years with a stable team. The team responsible for TPUT has been stable since this change. The higher yielding focus of TPUT has not changed. With a distribution yield of 5.3% at end September 2023, the fund offers an income advantage over the other pooled funds in which the Council invests and over the majority of other core, balanced funds in the peer group index. This higher income yield will have had a positive impact on recent performance. The fund is well balanced from a sector perspective. Almost half of the fund is invested in Industrial and warehouse assets. The fund is also overweight to the Retail warehouse sub-sector and underweight other Retail sub-sectors (high street shops, shopping centres and supermarkets). Columbia Threadneedle were more confident in carrying out sales during the very difficult 12 month period from Q3 2022. The team had to be flexible with what they sold and accept the changes to valuations throughout. This has put them in a much stronger position than some of their peers who were unable to agree on price and progress the same volume of sales over the period of significant market stress. We expect this could positively impact relative performance over the near term.

From an overall portfolio perspective, the Fund's pooled property allocations provide additional asset, tenant and geographical diversification. The Active Value investment will be realised naturally in the coming years, and the property exposure through Lothbury will also be paid back over the next year or two (if the potential merger does not go ahead). This would leave the pooled exposure through Federated Hermes PUT (FHPUT) and Columbia Threadneedle's PUT (TPUT). Both fund managers have been more successful at paying out the majority of redemption requests received than other UK property managers. They have both received new requests over the last quarter or two which means they once again have some outstanding redemptions to pay out but they are in a healthier position than some of their competitor balanced funds.

Both fund managers are working towards net zero ambitions for their respective funds and are transparent on reporting on their ongoing efforts in this regard. Federated Hermes has stated a net zero target of 2035 for FHPUT and Columbia Threadneedle has stated a target of 2040 for TPUT. Both managers have been working on journey plans for their respective funds to deliver to these target dates. This could be valuable for the Council's internal property team to benefit from the learnings of their pooled fund managers and to leverage off their work in this regard, particularly as the managers have dedicated ESG resource providing support.

We believe these two pooled property funds are complementary and will continue to offer some style diversification. TPUT continues to focus on higher yielding properties, generating a higher income, while the FHPUT portfolio tends to be more focused on prime assets and locations with underlying optionality often backing valuations.

Pooled infrastructure fund

JP Morgan's Infrastructure Investment Fund

- The fund's 12-month returns to 30 September 2023 were 9.2% (net) in local currency terms and 10.4% (net) in USD hedged terms with a 12-month cash yield of 6.0% (5.9% from operations, 0.1% from return of capital). Both metrics are in line with the fund's target of a total return of 8-12% net p.a. and a cash

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yield of 5-7% p.a. over an investment term of 5-7 years. JP Morgan expect end of year returns and cash yield to be about the same, which would make 2023 a strong year for performance and slightly ahead of both 2021 and 2022. In general, the fund has performed well to date and we have confidence in the team's ability to continue to add value through operational improvements.

- As of 30 September 2023, the fund's NAV was c\$34.5bn with the capital invested in 20 underlying portfolio companies and 967 assets. Leverage across the portfolio is at a reasonable level (50%). Over Q3 2023, the Fund received \$1.0 billion in new commitments and reinvested distributions and paid out \$0.7 billion of redemption requests. The capital queue has shortened to three months or less from the date of investment and the fund continues to pay out redemptions within five months of the bi-annual redemption dates (June and Dec).
- We rated JP Morgan's IIF as Strong on Responsible Investment (RI) in our last review of their RI processes, integration and reporting in 2021. We expect to review our RI rating of the fund during 2024.

Private Debt Investments

Partners Group Multi-Asset Credit IV, VI and VII (Corporate Lending)

- MAC IV was the largest fund in the MAC series (initially raised £1.1bn). IRR as of Q3 was 4.7%. The fund is in wind down with only 17 loans left (as of Q3). Fund maturity was originally set to be September 2023, but this has been extended to September 2024 (with a further 1 year possible).
- MAC VI is now fully committed and PG have made their first distributions. The investment period ended in December 2023 and the fund had 78 investments as of Q3. As we expected, the fund has invested overwhelmingly in senior secured debt (96% as of Q3) and is skewed to North America vs Europe. IRR as of Q3 was 6.3%.
- A £10m commitment was made to MAC VII in March 2023 and the first capital calls took place in Q4 2023. We expect senior loans made today to have double digit gross returns so we expect the manager to skew the portfolio towards senior loans at lower advance levels. This should reduce risk. We are more concerned about loans underwritten in the post-Covid "bounce" which may experience higher defaults and lower recoveries.

CRC Fund V (Bank Risk Transfer)

- The Fund invests in CRF V, which is still in its investment period, but is due to begin making distributions to investors during 2024.
- Performance of this vintage has been in line with expectations, with net IRR since inception to Q2 2023 on the GBP share class around 11% p.a. (*source: results summary; CRC*)
- The manager confirmed in Q2 2023 that all holdings are performing in line with, or ahead of expectations, and that underlying loan defaults continue to run below regulatory probabilities of default.

Future returns expectations

We set out below some expected returns for the 3 main asset classes in which the Fund invests.

Asset class	Expected (forward looking) 5-year total return p.a.
Property (Direct and Indirect; see comments)	6.0%
Infrastructure (JPM)	8.5%
Corporate Lending (Partners Group)	8.0%

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Bank Risk Transfer (CRC)	10.0%
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Source: *Hymans Robertson*

Our estimations are based on a combination of our in-house stochastic modelling assumptions, market consensus forecasts, fund manager targets, and in-house research views on asset class and fund manager expectations, based on the current market environment. They are therefore subjective and intended to provide a high-level estimation rather than anything specific to this portfolio. They should therefore be taken as a broad market expectation and in particular don't reflect the actual composition of the direct portfolio (e.g. the overweight to Offices) nor the prospects for individual assets.

We note that our 6% p.a. expected return for property is above the latest Investment Property Forum (IPF) consensus forecast of 5.6% p.a. but the most recent IPF figure still included capital declines for 2023 (that have now already occurred) within that 5-year forecast.

We do believe that the portfolio has the potential to deliver on the Fund's total return objective of 7% p.a. Both the latest IPF consensus forecast and our estimate above for core property are below the Fund's objective target return but the Fund's development exposure (for which we have not attempted to derive an allowance for outperformance versus core market) and infrastructure investments (which are leveraged) help to boost return expectations for this portfolio relative to the core property market.

5 Strategic Proposals

Based on our analysis of the Fund's portfolio, we make a number of strategic recommendations for consideration for both the direct property and diversifiers portfolios. These are outlined below.

Overall portfolio composition

The Fund comprises a core portfolio of directly-held properties located in Leicestershire and a portfolio of diversifying investments in property, infrastructure and private debt. Many of the directly-held properties support the Council's wider policy objectives, but the diversifiers portfolio includes treasury management assets and investments held for commercial purposes. The current portfolio mix is approximately 67% direct property and 33% diversifiers. We believe the current mix is appropriate and strikes a reasonable balance between the positive economic, social and environmental impacts generated in the direct portfolio and the downside protection provided by the diversifiers portfolio.

Given the volume of new investments to be made, we expect the direct portfolio to see only modest growth. We therefore recommend that the Council explores opportunities to dispose of certain existing assets and recycle the capital into new developments. This will enable the Fund to maintain a high level of positive impact in the local community, as well as providing the opportunity to implement some of the portfolio refinements proposed below.

Approximately 29% of the capital currently committed to the direct portfolio is invested in new developments. New developments create impact, but also reduce the level of current income and certainty of income. The current proportion of development capital is high for a portfolio designed to generate income – 20% would be the usual limit – but we acknowledge that the Fund also has an impact objective, and we note that a number of major developments are currently being progressed. We therefore believe the current level of development financing is reasonable.

Direct property portfolio

The direct portfolio comprises properties in the Industrial/Logistics, Office and Rural sectors, recent investments in the Alternatives sector and current developments in Residential, Industrial and Alternatives.

Our recommendations for your consideration based on your current exposure are as follows, and we'll delve into more detail on each in turn:

- Increase the allocation to the Industrial/Logistics sectors;
- Maintain or reduce the allocation to Offices;
- Selectively consider Retail investments;
- Maintain the Rural allocation;
- Cap the allocation to Residential;
- Increase the allocation to other Alternative sectors.

Increase the allocation to the Industrial sector

The Industrial sector spans properties used for manufacturing, storage, logistics and distribution.

Structural changes to consumer habits such as the shift to online shopping have materially boosted demand for good quality and well-located Industrial space, whilst supply has remained fairly constrained. Consequently, demand from online retailers for large distribution and urban logistics facilities located close to major markets has surged, resulting in strong rental growth.

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These strong fundamentals, particularly relative to other commercial property sectors, led to greater investor demand and higher capital values – Industrial asset values rose by 58% over the 24 months to end June 2022. The resulting low yields were then more vulnerable to rising rates, leading to values adjusting sharply, falling by 28% over the 8-month period to end February 2023 (though we have seen some recovery since then).

The occupational market has been softening recently. New developments have chipped away at some of the undersupply, but the recent period of high inflation and rising debt costs has increased construction costs, which should prevent a glut of new supply coming to the market over the short-to-medium term, meaning an undersupply of good quality Industrial property should remain in some locations.

We recommend the Fund increases its allocation to Industrial assets. Given Leicester's central location in England, its proximity to major motorways and large population centres, and strong manufacturing heritage, we believe the fundamentals of the area are supportive to the sector going forward. Logistics assets are likely to benefit from the continuing growth of e-commerce, whilst certain Industrial sub-sectors should benefit from more proactive Industrial policies. In addition, the Fund is underweight Industrials relative to the wider property market, where this sector has become increasingly dominant.

The pricing of Industrial assets has risen sharply in recent years, so we believe the Fund should focus on high quality, well-located units with strong environmental credentials. Focusing on new developments and/or the refurbishment of existing assets would increase the level of impact achieved, although the cost of doing so must be balanced against the need to generate current income. We recommend that the Fund considers disposing of the smaller assets and recycling the capital into larger units. This may provide the opportunity to reduce asset management costs and improve portfolio quality, whilst maintaining good diversification.

Maintain or reduce the allocation to Offices

We recommend the Fund maintains or reduces its allocation to Office assets. Nationwide the office market is over-supplied given the shift in the balance between office-based and home-working now appears permanent. We suspect the full impact of this shift on rent levels and asset pricing has yet to be felt. The office sector will not disappear but competition for tenants will increase. We expect Offices with strong tenant demand, good transport links, good on-site amenities and strong environmental credentials to fare materially better than those without.

The Fund has three key office assets and three much smaller, less significant direct office holdings. While performance has held up, it may be worth reflecting on how time consuming the management of the smaller properties are and whether it remains worthwhile to continue to hold the smaller assets for the longer term or whether recycling capital into another asset that can have more of an impact would make more sense.

The Fund's allocation to office assets will naturally fall if no further investments are made as the Fund grows. But we recommend that the Fund explores opportunities to dispose of selected assets, recycling only some of the capital released into this sector. This may provide opportunities to improve the diversification of the remaining portfolio and reduce tenant concentration, whilst maintaining the ability to create positive impact through selective investments in what will remain an important sector.

We also recommend that the Fund reviews the business plans for retained assets to ensure that all necessary refurbishments and associated capex requirements have been identified, with a particular focus on meeting tenants' more exacting requirements and achieving compliance with current and prospective environmental regulations, in particular in relation to the Minimum Energy Efficiency Standards (MEES) which currently dictate a minimum Energy Performance Certificate (EPC) rating of E for any new leases and will require a minimum EPC C rating by 2025 for commercial properties. These observations apply to all property sectors of course, but in our experience, it is easier to under-estimate ongoing investment requirements in the Office sector.

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Selectively consider Retail properties

The Retail sector had been on a downward trend for most of the decade before the COVID pandemic due to oversupply and structural changes, particularly due to the rise of e-commerce. This trend accelerated during the pandemic when non-essential shops were forced to close. The sub-sectors of supermarkets and Retail parks have proven more resilient. Retail parks often support “click and collect” offerings, provide free parking and have a mix of convenience and bulky goods retailers that many people prefer to buy in person.

The path to recovery in Retail has been beset with challenges. This was exacerbated by inflation pushing prices higher and by rising interest rates, both of which have impacted household spending, particularly in relation to discretionary spending. However, we expect some Retail supply to reduce over time as Retail space is repurposed for other use. The Retail sector is now offering investors a higher income yield and many Retail rents have rebased, which provides potential for rental growth going forward.

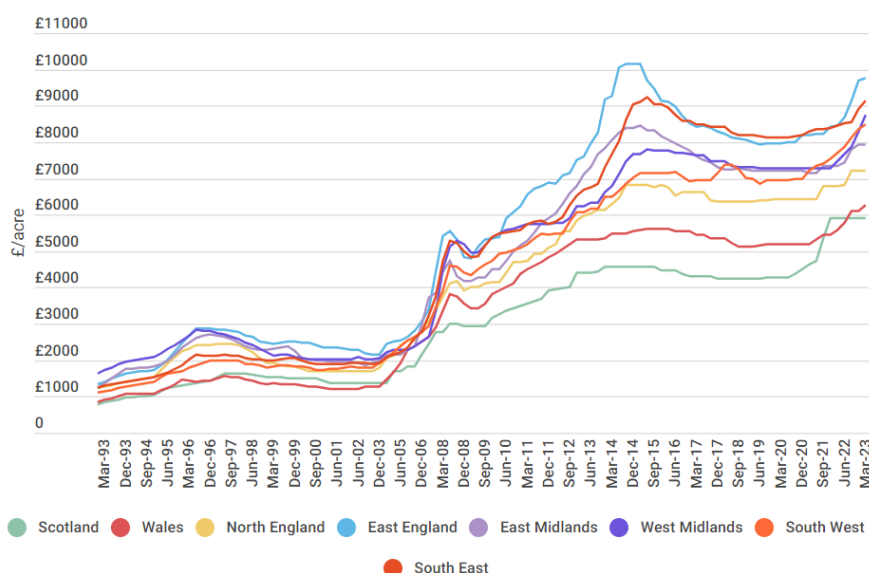
We recommend the Fund considers opportunities in the Retail sector, but on a highly selective basis. The headwinds experienced by the Retail sector, notably the growth in online shopping, are expected to persist and there remains surplus capacity. However, there are some successful Retail formats, and yields have risen sharply (see Chart 2).

We believe the Fund should focus on investments which act as catalysts for wider regeneration activity and are expected to generate meaningful economic or social impacts, but which also have a strong commercial proposition. Potential opportunities include convenience Retail, Retail parks and high street units used to deliver face-to-face services with a particular focus on assets that are likely to fall “below the radar” of the major property investors.

Maintain the Rural allocation

Rural land values have increased substantially across different regions of England and Wales over the last 2 years as shown in the chart below.

Chart 5: Land values by region over last 25 years



Source: Savills Research

The supply of Rural land has substantially decreased since the early 2000s, which according to a report by Knight Frank, has helped the sector keep pace with recent double digit inflation levels.

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Knight Frank commented that the upcoming General Election could cause the market to flatten in 2024. However, supply remains constrained and the range of opportunities for alternate use of land (some further comment below) should continue to support the sector beyond this year.

We believe the Fund should maintain its allocation to Rural assets and actively seek to add value through asset management. Capital appreciation and income generation has historically been lower than other property sectors, in part because of the prevalence of individual owners who are reluctant to sell but lack the capital/succession to develop the full potential of their assets. Nonetheless, we acknowledge that the Rural sector is a key part of the Leicestershire economy and appreciate why the Fund seeks to support it.

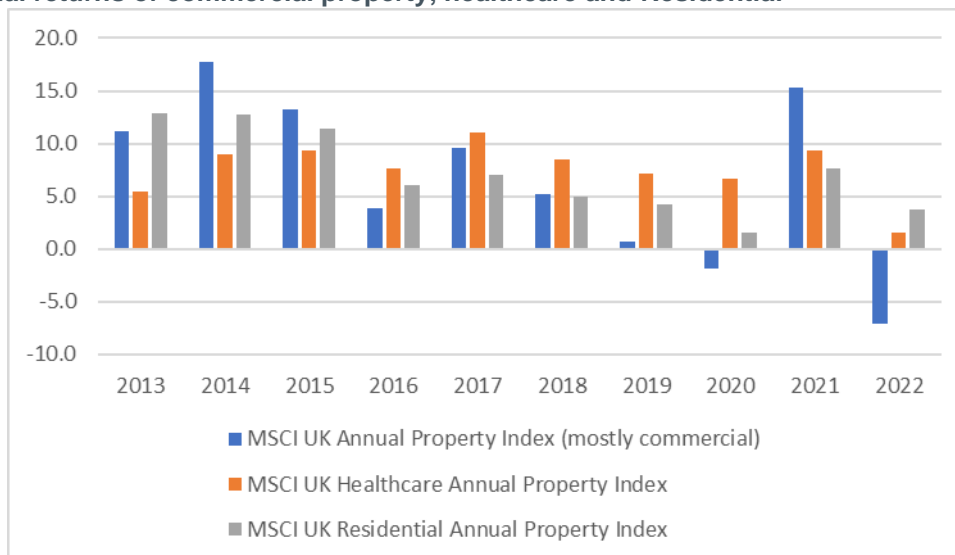
We recommend that the Fund focuses on assets that have significant potential for value appreciation through asset management. This could include re-negotiating lease agreements, leveraging Council buying power and/or generating revenue from collocated leisure or renewable energy generation facilities (e.g. onshore wind, solar farms). Opportunities to add value through the provision of ecosystem services including biodiversity, carbon sequestration, flood prevention and improved air/water quality should also be explored. These will include generating revenue from the sale of carbon and biodiversity net gain credits and through participation in the UK's new Environmental Land Management schemes, the system of direct payments for public goods introduced following the UK's exit from the EU Common Agricultural Policy.

Alternative sectors

Allocations to alternative property sectors, such as such as hospitality, leisure, data centres and Residential, have been growing in the UK for many years now. This has been to increase portfolio diversification, often to provide more defensive income streams and sometimes in the expectation of higher returns.

The chart below shows performance in recent years of the Healthcare sector and of the Residential sector, measured by MSCI, compares favourably relative to broader commercial property over recent years (2021 excepted).

Chart 6: Annual returns of commercial property, healthcare and Residential



Source: MSCI

Note the above chart only runs to the end of 2022. We expect some Residential valuations will have corrected in 2023 because of rising interest rates.

The Alternatives sector includes a diverse range of opportunities, some of which have benefited from trends in recent years including the growth in leisure, hospitality, nurseries, primary healthcare and laboratories etc. The dispersion of returns, between assets and over time, has been wide which means a selective approach is

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critical. But generally, investors have benefited from more favourable supply and demand dynamics than they have from other sectors such as Office and Retail.

Cap the allocation to Residential property

We believe Residential remains an attractive sector offering stable income streams, sustained capital appreciation and clear economic/social benefits. It tends to be the most resilient property sector, as individuals typically prioritise paying rent over other expenses regardless of the economic situation, and diversifies the risks associated with a commercial property portfolio. It is however lower yielding than other property sectors.

The Fund is currently financing a large Residential development at Lutterworth East and has one further development in its pipeline. Whilst we don't know what the value of these developments will be once complete, Lutterworth East alone is already worth 23% of the direct portfolio. This would be a significant overweight to the wider market. Residential developments can have significant economic and social impact, so we believe it is appropriate for the Fund to maintain an overweight position. But Residential housing once completed is likely to dilute overall returns and can be challenging to manage. We therefore recommend that the allocation is capped at 15% of the direct portfolio, with some of the Lutterworth development being sold to achieve this level of exposure.

Selectively increase the allocation to other Alternatives

In other Alternative sectors we would encourage the Fund to continue to diversify exposure into other parts of the market offering attractive risk-adjusted returns. We believe the Fund should focus on a limited number of new asset types in which the internal team can deepen their expertise, and which reflects the nature of demand in Leicestershire.

Other asset classes – local infrastructure and corporate lending

The Fund is considering making an investment in a solar facility at Quorn, its first direct investment outside conventional property. We would expect the Fund to see many opportunities in this and other “granular” classes of infrastructure including onshore wind, power transmission lines, EV charging, communications towers etc.

We believe local infrastructure assets are potentially attractive additions to the Fund's direct portfolio, offering a good income yield, potential diversification and clear economic and environmental benefits. They would also be supportive of the Council's wider policy objectives. However specialist expertise is required to develop and manage them successfully. We therefore recommend that the Fund focuses on local projects that can be developed in partnership with specialist infrastructure managers. This will enable the Fund to leverage the Council's own local knowledge and ability to influence project outcomes and the manager's technical expertise, thereby ensuring better risk-adjusted returns. As with the Alternatives sector, focusing on a limited number of asset types would enable the internal team to develop its expertise over time.

The Fund may also wish to consider secured lending to local businesses. We would expect these to be categorised as treasury management assets and they may also be supportive of the Council's wider policy objectives. As with local infrastructure, we would recommend developing opportunities in partnership with specialist managers. However we note the potential difficulties of implementing this, for example whether a suitable manager can be identified. Consideration should also be given as to whether the potential financial returns would be consistent with the Fund's objectives.

Diversifiers portfolio

Allow the allocation to pooled Property to fall but ideally not below 25%

The Fund invested in pooled property funds partly to deploy capital quickly into income-producing assets, but also to diversify the asset and tenant concentration risks associated with its direct property portfolio. The proportion of assets held in this way has fallen as direct properties are developed or acquired. We believe there is still a case for diversifying risk in this way, and would suggest that the Fund maintains an allocation ideally of at least 25% to ensure adequate diversification.

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The portfolio currently comprises five pooled funds. Two of these are closed-end funds, initially managed by Aegon and now managed by DTZ, which will return capital to investors over the next two years as the underlying investments are realised. The other three are open-ended funds managed by Lothbury Investment Management, Federated Hermes and Columbia Threadneedle. The Lothbury fund is now being liquidated although another fund manager, UBS, is preparing to put an offer to investors to take over the management of the fund, merging the remaining assets with its UK balanced fund, UBS Triton.

The Fund will not be able to re-invest capital into other pooled Property funds because they are deemed to be held for commercial purposes. In order to maintain exposure and to avoid further transaction costs, we recommend the Fund gives serious consideration to supporting the proposed merger, if comfortable with the terms of the deal once the details are shared with investors. We can provide support to the Fund in making this decision when the time comes to do so (expected to be later this quarter).

The two remaining funds are managed by Columbia Threadneedle and Federated Hermes. Both invest in commercial property across the UK and have a strong income focus. Our rating of both funds is Positive which means that we believe there is a strong chance that their investment strategies will deliver their objectives. In our review of both, we also found reasonable evidence of Responsible Investment best practice being applied.

Maintain the allocation to pooled Infrastructure

Performance has been generally positive across the asset class as a good portion of infrastructure assets can pass on inflation increases with no cap, but the sector has not been immune to recent headwinds. Some assets may have underperformed previous years' expectations or 12-month business plans due to slowing economic growth affecting cashflows and higher interest costs and lower availability of debt affecting the case for new acquisitions. Valuations have also come under pressure and, although they showed some signs of stabilising later in 2023, further reductions are possible as private infrastructure valuation multiples are still above their long-term average. Some sub-sectors (such as healthcare, digital infrastructure, and renewables) were more resilient to re-valuations compared to other sectors given investor support for long-term secular trends such as digitisation and decarbonisation. Given the hold-to-maturity profile of most funds, exits are unlikely to be a point of concern for long-dated funds. Most funds will likely focus on preserving value over 2024 and value-add initiatives and new transactions are likely to be lower in volume or size compared to previous years.

Operational infrastructure provides a good income yield and, because it is typically involved in the provision of the essential services on which modern economies depend, it provides strong downside protection at times of economic stress. Responsible infrastructure developments typically also have positive economic, social and environmental impacts notably in relation to climate change. Many developed economies have experienced chronic under-investment in infrastructure for many years, frustrating their ability to deal with the challenges of the pandemic, geopolitics and climate change. This is creating a favourable supply and demand dynamic.

Ideally, we believe the Fund should increase its allocation to Infrastructure to say 25% of the diversifiers portfolio. We acknowledge that this recommendation cannot be implemented through pooled fund investments at the present time because such investments would be held for commercial purposes which is not permitted under current regulations. We therefore recommend the Fund maintains its current allocation of 10-15% of the diversifiers portfolio. We note direct investments in local infrastructure projects that support the Council's wider policy objectives could still be considered.

The Fund is currently invested in the JP Morgan's Infrastructure Investment Fund. We rate this fund Preferred, which means we believe JP Morgan offers one of the strongest infrastructure funds available to institutional investors. Nonetheless, if the Fund were to increase its allocation to the asset class via pooled funds in the future, we would recommend adding a second fund to diversify manager risk. A potential key factor in the selection of a second manager relationship could be the potential for the manager to generate and bring co-investment opportunities located in the Leicestershire area to the Fund. Local co-investment opportunities could be considered for inclusion in the Fund's direct portfolio.

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Increase and diversify the allocation to pooled Private Debt

A higher interest rate environment should mean higher returns for direct lending, as it's a floating-rate asset class. However, it also means higher debt burdens for companies to meet. Alongside other increased costs due to high inflation, this could make higher levels of default more likely. Loans underwritten at lower base rate assumptions are more likely to cause problems, and weaker corporate earnings could pile stress onto liquidity positions and further eat away at free cash flow generation. However, we do not presently expect default rates to rise dramatically because it looks like most developed markets will escape recession and companies generally have strong cash positions. Furthermore, we note that well-structured senior debt is better protected than equity, and that investors are currently being well compensated for taking credit risk with interest rates of c10%. Therefore, while there's a lot to be cautious about, we believe that private debt remains broadly attractive. That said, manager selection will be important, as this environment could show up problems in originating and underwriting.

Senior, secured private loans have characteristics which are a close match with the Fund's requirements. They offer a high income yield and strong downside protection by virtue of their seniority in the capital structure of the businesses/assets being financed. Investors typically also receive a return premium to compensate them for the additional liquidity risk being taken compared with investments in listed credit markets. Private loans can also deliver positive economic and social impact because, although lenders do not control the businesses they finance, they can exert influence through careful structuring of their loans and by exploiting borrowers' need for regular refinancing. Furthermore, we understand that pooled Private Debt funds would be considered to be treasury management assets and therefore eligible for investment under PWLB lending criteria.

We therefore recommend that the Fund increases its allocation but considers actions to diversify its exposure.

The Fund is currently invested in four closed-end private debt funds: three managed by Partners Group (Multi-Asset Credit Funds IV, VI and VII) and one by Christofferson, Robb & Company (Capital Relief Fund V).

Partners MAC vintages focus on senior, secured lending to mid-market corporates world-wide. The funds have delivered reasonable performance and we retain confidence in Partners as a private debt manager. However, there are strong alternatives available and we recommend that if further commitments are made in this area, consideration is given to investment with an alternative manager thereby diversifying manager risk.

Christofferson, Robb CRF V focuses on Risk Sharing Transactions (RSTs) with European banks in respect of their SME loan portfolios. RSTs are designed to insure the first (or second) tranche of losses on the underlying loan portfolio for a specified period. Investors reimburse the bank if relevant losses are sustained and receives a quarterly premium for doing so. The banks retain responsibility for servicing the underlying loans. By transferring the credit risk in their loan portfolios, banks can reduce the amount of regulatory capital they are required to hold against their loan portfolio, thus reducing the cost of capital of their core lending businesses.

RSTs have a risk profile comparable to subordinated debt. The insurance premiums received by investors generate a higher income yield than senior debt in normal circumstances, but losses can be higher in the event that default rates rise sharply across the market. Unlike equity, RSTs offer no upside potential. We believe RSTs have a place in diversified private debt portfolios, but we have some concern about the Fund maintaining a significant allocation given its focus on principal capital protection and as such would advise on a lower allocation with the diversifiers portfolio. CRF V will return capital to investors as the insurance programmes it has underwritten reach maturity, and we recommend that the capital released is recycled into other areas.

We recommend that the Fund considers three alternatives:

- Real asset-backed senior debt
- Trade finance
- Short-dated, listed credit.

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We believe all three would be classed as treasury management assets and therefore eligible for investment.

Real asset-backed senior debt. These are newly originated senior loans which finance real assets such as property or infrastructure assets/operating businesses. They typically benefit from a security interest in the assets financed and therefore offer strong downside protection. Interest is typically paid from a defined income stream, for example the rental income generated by the property. Capital is usually repaid by refinancing the assets. Interest margin and risk profile depend on the nature of the asset and the structure of the loan but are typically lower than general corporate financings. Interest rates on senior loans backed by real estate, which are typically investment grade, are currently 6-8%, whilst whole loans are yielding 8-10%. Interest rates on infrastructure debt range for 4-6% for loans secured against core assets, 6-10% where backed by value-add assets. A blended portfolio should therefore achieve the Fund's return target.

Real asset financing, like corporate lending, used to be the domain of commercial banks especially in Europe. Since the Global Financial Crisis, many banks have scaled back their lending in this area creating opportunities for alternative lenders. A very wide range of funds now exist, promoted by specialist and mainstream lenders. Most are closed-end funds.

An allocation to real asset-backed senior debt would diversify the Fund's existing private debt portfolio, whilst providing exposure to real estate and infrastructure markets in a way which complies with current investment rules.

Trade finance. This asset class covers a wide range of financing techniques including receivables/payable financing, inventory financing and supply chain finance. Financings are usually programme-driven with capital committed for several years, but individual obligations typically have short maturities (30-120 days). Credit risk can be mitigated by taking out credit insurance in which case the obligations would be rated the same as the insurance provider (usually single-A). But in any event default rates are typically very low because companies prioritise trade obligations even when under financial stress. Interest margins are typically 0.75% (with credit insurance) or 2.5% (without), giving an all-in yield in the range 6-8.5%. The global trade finance market is huge, but remains a specialist asset class for long-term investors. However, there are now a number of pooled funds, most of which are open-ended and offer monthly liquidity.

An allocation to trade finance would meet the Fund's return target and provide strong downside protection and a predictable source of income. It would also diversify the Fund's existing private debt portfolio.

Short-dated credit. Short-dated credit funds invest in public bonds issued by corporates, longer-dated bonds approaching maturity and commercial paper. Some also invest in short-dated government issuance. Typical portfolios have an average maturity in the range 2-3 years and a credit rating of single-A. Current interest rates are in the range 6-7%. There are a number of open-ended funds which target this asset class.

Short-dated credit funds do not invest in private debt, and their returns may fall short of the Fund's return target over the cycle, but we believe they offer diversification potential and merit consideration were the Fund to increase its exposure to credit generally.

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6 Pooled fund exit options

We are not recommending the Fund voluntarily exits any of its pooled funds, but we understand that it is required to consider exit options.

Were the fund to consider further reducing the number of investments in **pooled open-ended property and/or infrastructure funds**, opportunities to redeem via the primary market (i.e. directly with the investment manager) and secondary market (via the selling of units to another investor) should be explored to assess which would offer the Fund better value at that point in time.

Timing of an exit on the primary market is currently around six months for TPUT, FHPUT and JPM's IIF. Timescales could be extended on pooled property though if further redemption pressure arises. The cost of exiting is the NAV to bid spread on the units being sold.

Trading on the secondary market has been limited on UK property funds over the last year or so. For funds with significant redemption queues, indicative discounts have typically been moving between -5% and -10% over the last six months or so, depending on the extent of the queue and the perceived quality of the fund.

Secondary market pricing on Columbia Threadneedle's TPUT has materially improved as the Fund Manager has progressed sales and satisfied redeeming investors. The latest pricing indication we have on TPUT (from CBRE PropertyMatch) is around NAV -0.5%. This is currently better than the NAV to bid spread but pricing relies on finding a buyer at that price and could move quickly if a new buyer isn't found.

There has been no recent trading of Hermes' FHPUT. CBRE PropertyMatch provided a price indication of a mid-single digit discount to NAV but this is based on experience of other funds due to a lack of secondary market trading. We expect the primary market will likely be a better option if this is something the Fund wished to consider in the near term.

It is difficult to provide a price indication for Lothbury units at the moment as the outlook will very much depend on whether UBS takes over the management of some of the fund's assets, as part of an acquisition from its UBS Triton pooled fund (which has not been available on the secondary market due to lack of sellers). CBRE PropertyMatch indicated that secondary market pricing would likely become more attractive should the deal with Triton proceed. It's a binary situation as pricing will likely worsen if the deal does not proceed as only investors needing a quicker sale than the wind down will allow are likely to seek exit via the secondary market (and it's unlikely that there will be many buyers in that situation).

The secondary market of units in open-ended infrastructure funds has only recently started to open up. Some recent trades have taken place in JP Morgan's IIF. Current pricing indication is around NAV -2%. This will be dependent on agreement between the buyer and seller and is a little more complicated as there is a need to ensure the buyer can take over units in the same share class.

Exiting **closed-ended funds such as Partners MAC and CRC** would be far more difficult, as there is a limited secondary market for these. We don't expect there to be any secondary market interest for the Active Value funds now managed by DTZ. Waiting until investments are realised and capital is returned in the normal way is the more realistic exit option.

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Appendix A – Investment objectives, strategy and criteria

Investment objectives

The purpose of liLP is to generate income to support the delivery of front-line services, whilst contributing to the Council's strategic outcomes (see below)⁴ and the economic growth, social wellbeing and environmental sustainability of the county. Specific objectives relating to the programme's investments include:

- Maximise returns on Council-owned property assets;
- Maintain a diverse portfolio of energy efficient and sustainable direct properties and other investment assets which support economic growth and environmental sustainability;
- Contribute towards the Council's Net Zero Carbon Plan by reducing energy demand and increasing the generation and use of renewable energy;
- Focus investments in areas which increase the direct contribution towards policy objectives, maximise the potential to address economic and social market failure and enhance the value and marketability of the direct properties;
- Manage investment risk by investing across diverse sectors.

The overall target return is 7% net of expenses p.a..

Strategic outcomes

Clean and Green

- People act now to tackle climate change
- Nature and the local environment are valued, protected and enhanced
- Resources are used in an environmentally sustainable way
- The economy and infrastructure are low carbon and environmentally friendly

Great Communities

- Diversity is celebrated and people feel welcome and included
- People participate in service design and delivery
- Communities are prepared for and resilient to emergencies
- Cultural and historical heritage are enjoyed and conserved
- People support each other through volunteering

Safe and Well

- People are safe in their daily lives
- People enjoy long lives in good health
- People at the most risk are protected from harm
- Carers and people with care needs are supported to live active, independent, and fulfilling lives

Improved Opportunities

- Every child gets the best start in life
- Every child has access to good quality education

⁴ As well as objectives set out in the Medium-term Financial Strategy, the Corporate Asset Management Plan, the Economic Growth Plan and the Local Industrial Strategy

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- Families are self-sufficient and enabled to be resilient
- Everyone is able to aim high and reach their full potential

Strong Economy, Transport and Infrastructure

- There is close alignment between skill supply and demand
- Leicestershire has the infrastructure for sustainable growth
- Leicestershire is an attractive place where businesses flourish
- Economic growth delivers increased prosperity for all
- Leicestershire has the right homes in the right places to meet needs

Investment strategy

The current strategy as set out in the 2023/27 strategic plan is to:

- Develop new or existing assets to meet Council service needs where this will reduce operating costs or, for example, meet local housing needs;
- Continue to acquire both parcels of land for development and standalone direct property investments that contribute to the attainment of policy goals or address areas of economic or social market failure;
- Make better use of existing, underperforming investment assets or re-develop them as appropriate;
- Restructure and rebalance the property portfolio;
- Utilise Treasury Management assets to provide diversification by sector, geography and asset class;
- Review the performance of all investments and dispose of any assets where performance cannot be improved to an acceptable level.

Investment criteria

All opportunities are evaluated against the following criteria, and any investments made should:

- Provide adequate liquidity supported by a clear exit strategy;
- Safeguard the principal capital invested;
- Make a positive contribution to strategic objectives and/or addressing areas of market failure;
- Generate a financial return commensurate with the risk being taken, under a range of economic scenarios;
- Clearly identify risks and liabilities (including land contamination and end of life costs);
- Meet current environmental sustainability requirements and have a plan in order to meet further prospective requirements;
- Demonstrate good fit with the current portfolio.

In addition, direct property investments are assessed against the following criteria:

- Economic benefit – job creation, ability to address market failure
- Income potential – once development completed
- Tenant quality – covenant strength
- Location – preference for assets in areas of the county requiring regeneration

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- Sector – investment prospects in relation to asset location
- Building – age and quality of construction, including environmental sustainability, and future capex requirements

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Appendix B – Infrastructure Market Review

What happened last year?

Performance across funds will differ based on the quality of assets held and the capital structure but was overall positive across the asset class as a whole. Assets may have underperformed previous years' expectations or 12-month business plans due to slowing economic growth affecting cashflows (particularly for GDP-linked assets) and higher interest costs and lower availability of debt affecting the case for new acquisitions. In particular, we have noticed a divergence in performance between assets and strategies which are able to pass on inflation and have already secured low interest costs, and those that cannot. Generally, performance was positive across the asset class as a good portion of infrastructure assets can pass on inflation increases with no cap.

Asset valuations showed some signs of stabilising over 2023 although we note that private infrastructure average EV/EBITDA multiples are still above the long-term average, so a further reduction is possible. Listed infrastructure multiples are already close to the bottom of the historic range and have re-priced more quickly than private infrastructure. One of the factors providing a floor for valuations in core and core-plus assets was the high levels of dry-powder available. This trend was most apparent in long-dated infrastructure assets with future cash flow visibility, stable capital structures and strong fundamentals as buyers have higher confidence in these assets. Additionally, some sub-sectors (such as healthcare, digital infrastructure, and renewables) were more resilient to re-valuations compared to other sectors given investor support for long-term secular trends such as digitisation and decarbonisation.

2023 was a tough year for new fundraising in infrastructure due to the denominator effect and the relative attractiveness of other, more liquid asset classes that had repriced more quickly. The latest fundraising data shows that the number of funds and volume of capital raised over 2023 is far below levels seen in the last 10 years. This led to target closes for funds being pushed back, increased selling activity on the secondary market and consequently, infrastructure secondary funds being positioned as a tactical opportunity. This is likely a cyclical trend that will correct in the short-term as most investors still have a positive long-term view on infrastructure as an asset class.

Medium-term outlook

In the current market environment, infrastructure assets can be useful to access a consistent inflation-linked income stream. Interest in infrastructure is further supported by the secular trends of decarbonisation and digitalisation, as well as favourable regulations for these sectors.

The decarbonisation trend and transition to green energy has increased interest in the renewables sector. The Inflation Reduction Act in the USA and the European Green Deal have provided favourable tax incentives and strong regulatory support for further investment in renewables and energy transition assets. On-going hybrid working and an increase in global data consumption has kept the digital infrastructure sector in high demand, which continues to attract substantial capital in-flows for the sector.

Across the asset class, we expect managers will focus on improving the operational performance of assets and maintaining valuations over the short-term. Although the cost of credit is now higher, many infrastructure assets operate on long-term credit facilities and the impact on assets requiring near term re-financing is low. However, as financing for new acquisitions has become more expensive and less accessible, we expect transaction activity will reduce. Managers are likely to prioritise transactions in high-quality assets, transactions with low competition and those involving experienced counterparties. Dry powder is likely to be called up more quickly and we have already seen a shortening of queues for open-ended funds from 12-18 months down to 6 months.

Given the hold-to-maturity profile of most funds, exits are unlikely to be a point of concern for long-dated funds. The tactical opportunity in secondary infrastructure funds will most likely be short-lived and fund pricing could stabilise as many investors have already re-balanced their portfolios over 2023.

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In summary, most funds will likely focus on preserving value over 2024 and value-add initiatives and new transactions are likely to be lower in volume or size compared to previous years. The key to unlocking more transactions will likely be a fall in interest rates as the economy stabilises.

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Appendix C – Private Debt Market Review

As the name suggests, private debt is debt that isn't publicly traded. However, beyond that definition, there are a multitude of private debt strategies available. We focus here on direct corporate lending i.e. sub-investment-grade equivalent, non-bank lending to corporates, which are typically privately held entities. This is the most popular allocation among private debt investors and is typically what the media refers to when discussing 'private debt'.

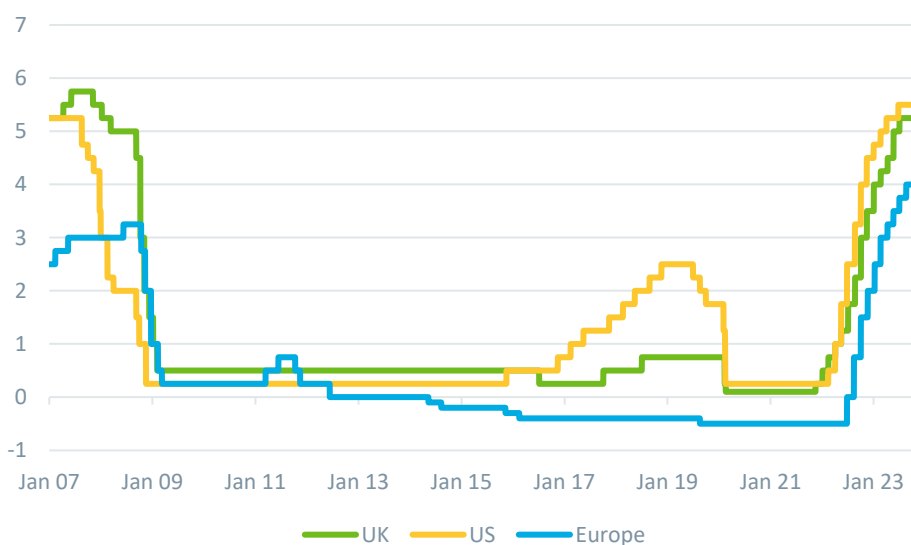
Throughout 2023, we've heard many managers and journalists refer to this as the 'Golden Age of Private Credit'. But what does that actually mean? We've left behind the near-zero interest rate environment that followed the global financial crisis, and higher base rates mean higher returns for direct lending, as it's a floating-rate asset class. This benefits investors, and it could well prove the 'Golden Age' theory. But we need to be cautious about the other edge of the higher rates sword – higher base rates mean higher debt burdens for companies to meet. Alongside other increased costs, thanks to inflation, this makes higher levels of default very likely.

The other factor that should give caution is the sheer amount of capital that's flowed into the asset class. While fundraising was a struggle across private markets in general, investor allocations were most robust in private debt. The amount of 'dry powder' has increased, putting pressure on managers to deploy capital to start earning fees (typically charged on invested capital in direct lending).

What happened in 2023?

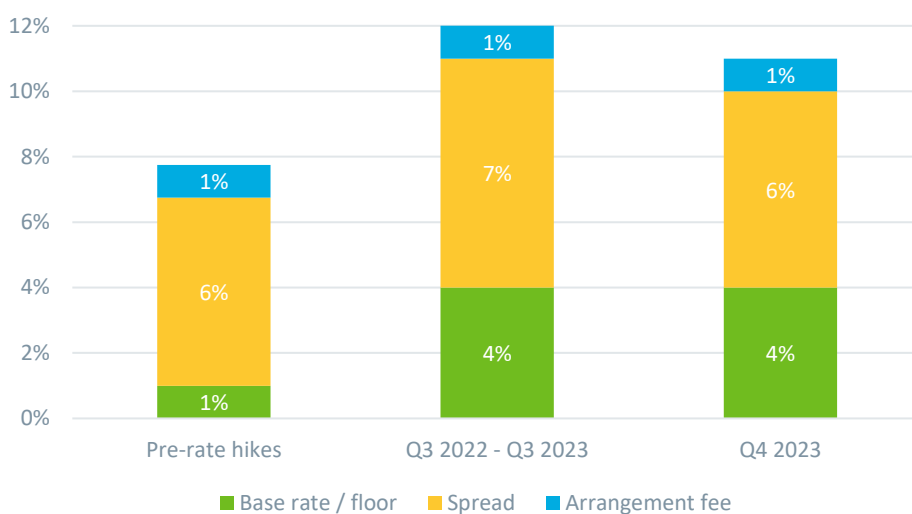
In terms of valuations, spreads widened significantly at the end of 2022 and in the first half of 2023, meaning that new direct corporate lending senior loans were being underwritten with spreads in excess of 700. But spreads have narrowed towards the 600 mark since the middle of 2023, with some deals now being done at levels under 600, a more normalised margin spread (see charts below for indicative breakdown of returns). However, the higher base rates are supporting the now higher expected returns, while gross level asset returns are still in low double digits. Acknowledging that base rates are likely to be higher for longer than was originally expected, some managers have increased the target returns on their funds. But we note that, for the most part, hurdle rates by which performance fees are measured haven't moved.

Chart 7: Base rates GFC to now, January 2007 to December 2023



Source: Datastream

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Chart 8: Indicative return breakdown change for a direct lending loan in Europe*

Source: HPS, Hymans Robertson

* We've used a 3% arrangement fee here amortised over 3 years for simple maths, but arrangement fees have remained stable in the 2.5–3% range.

In the second half of 2022, and throughout 2023, we saw a material pullback in M&A activity, with volumes down significantly. This meant that private debt activity moved its focus on acquisition financing to refinancings or smaller add-on financings. Because private equity sponsors weren't getting as many deals done, many loans that were expected to be repaid from a sale had to be extended. This, in turn, has had an impact on expected fund maturities across direct lending, whereby managers have had to seek investor consent to extend their closed-ended funds beyond their initial life.

What 2024 might bring

We can certainly see the potential benefits for fund vintages investing in 2022 and 2023, as managers have underwritten loans with the reality of these higher base rates and, with an eye on interest-coverage ratios, have consequently reduced leverage. But loans underwritten at lower base rate assumptions are more likely to cause problems. Particularly assets written in the post-Covid 'bounceback' rush of activity, where many loans were issued with loose documents, cov-lite (or non-binding covenants), and/or at high leverage that's simply unsustainable with a higher interest burden. Weaker corporate earnings could pile stress onto liquidity positions and further eat away at free cash flow generation. As pressure on debt affordability metrics grows, it's likely that direct lending loan defaults will rise, and recovery prospects for cov-lite loans could be worse for the end investor.

As direct lending has become more mainstream, investors have increased their allocations, and some private debt allocations have matured. Some investors could seek diversification away from the corporate risk of direct lending, notwithstanding the weakening fundamental outlook for corporates. We note that asset-backed lending, regulatory capital relief and fund financing are potential areas of interest. Meanwhile, opportunistic credit investors may take advantage of the aforementioned stress in the system. Likewise, we think investors may consider real asset debt as a relative value alternative to their real asset equity allocations. We note that the credit secondaries market is continuing to mature and offers attractive returns, given a stark difference in supply and demand.

Responsible investment continues to be an important focus for managers. With direct lending funds that launched in 2023, it was almost market standard to be categorised as Article 8 under the Sustainable Finance Disclosure Regulation. However, compliance makes demands of asset managers' internal resource, which

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impacts the smaller managers more. Certainly, at this point, integrating ESG into the investment process is a minimal expectation, but many managers are seeking to do more at firm level, investment strategy and in their reporting. Finally, environmental or societal impact private debt has launched only a small minority of funds. We expect this to increase, but it's unlikely to be a dramatic shift.

While there's a lot to be cautious about, we believe that private debt remains broadly attractive. That said, manager selection may be important, as this environment could show up problems in originating and underwriting.

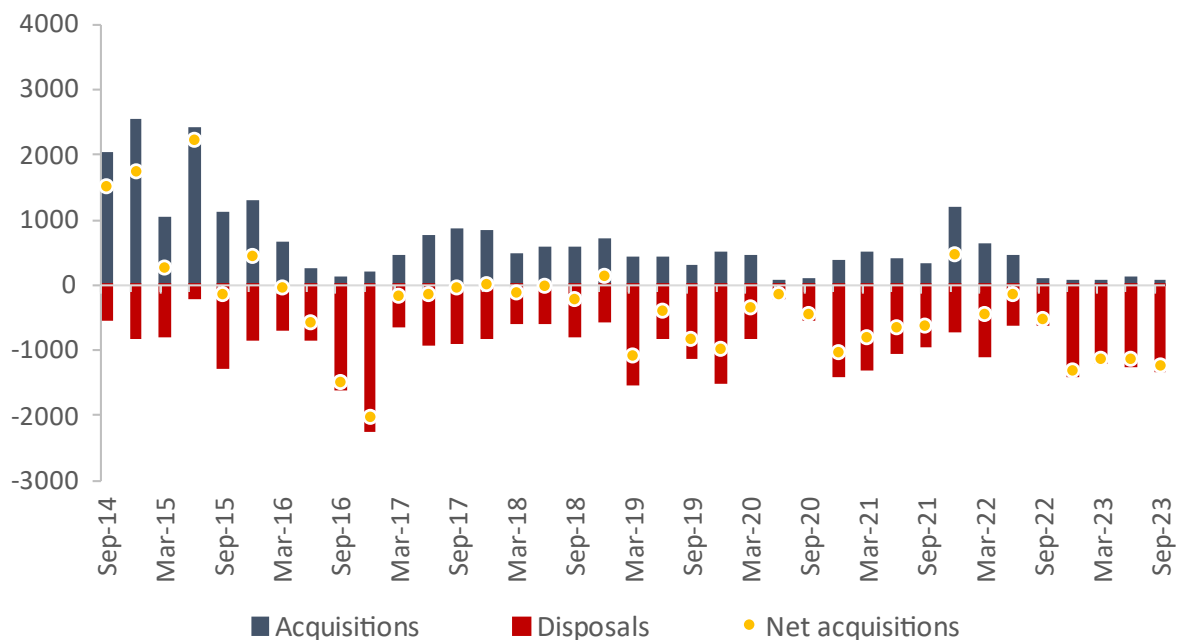
Appendix D - Overview of current situation facing UK pooled funds

Asset flows

The MSCI UK All balanced (open-ended) Property Funds Index consisted of over 20 funds valued at c.£27bn in aggregate at end December 2022, down from £34bn at end December 2021.

The c.26% drop in value of the underlying funds that make up the index over the year can be partially attributed to capital declines in the second half of 2022, as well as from investors selling UK core property funds as part of their portfolio rebalancing, and the wider de-risking of private sector DB pension schemes. The chart below illustrates the extent of outflows from Balanced Property funds over the past 10 years. In general, property funds have been net sellers of property over the period as redemptions have generally outstripped new money entering funds, particularly over the last 5 years.

Chart 9: Acquisitions and disposals from UK property funds (£m)



Source: MSCI September 2023

Pooled property fund liquidity

Pooled property funds have been experiencing significant investor withdrawals since the property market peaked and interest rates started to rise. This selling pressure has been industry wide, and an absence of new investors forced most property funds to delay the payout of redemptions. The catalyst for the redemption pressure was several coinciding factors, including:

- Pension funds with Liability Driven Investment (LDI) mandates sought to dispose of realisable assets to meet collateral demands across a wide range of assets (including property units), but particularly gilts.
- Gilt yields increased significantly, which in turn inferred a higher risk premium for all UK assets.
- Some property asset yields were suddenly below gilt yields, in turn implying lower future property values and therefore a benefit to some investors to submit early redemption requests.
- Private Defined Benefit (DB) pension schemes realising previous gains as they continued an industry trend to reduce their exposures to illiquid return-seeking assets as part of wider de-risking activity.

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Some of the pooled funds have now managed to accommodate the majority of the selling pressure they experienced. Other funds continue to have a substantial balance of redemption requests to meet and will likely require the majority of 2024 to accommodate exiting investors. We are aware of at least 2 balanced funds that are to be wound down and expect there will be a few more that will not survive over the long term as a result of selling pressure.

Manager actions

It became difficult to sell properties during the second half of 2022 as there were very few buyers in the market and it was clear that there was a substantial mismatch between buyer and seller price expectations. Some managers of pooled funds held back transacting on properties after price discovery as they were reluctant to oversell into a falling market. As a result they continue to have substantial volume of redemptions to meet. While other managers had been selling earlier in 2022 and continued with their selling activities. It's no surprise that the managers who continued to progress sales following price discovery are now less impacted by redemption pressures.

Managers reported having to be flexible with what is being sold – testing the market's appetite for different types of assets based on factors such as size, location, sub-sector, and quality. Some managers communicated that regardless of what they offered to the market, nothing was selling at the height of the liquidity squeeze in late September / early October. With low trading volumes, we understood that some managers were holding back putting properties onto the market for sale to avoid 'tainting' the asset if a buyer did not emerge.

Several managers are now past the worst of the redemption pressure, but for some funds it will likely take the majority of this year and potentially some time in 2025 to get through their redemption queues. We anticipate more selling pressure could emerge as private sector DB pension schemes continue to de-risk and seek to increase their allocations to liquid assets on an ongoing basis.

Around 1/3 of units in UK balanced property funds were owned by private sector DB schemes at the beginning of 2023. This percentage is likely to have dropped over the year with many DB investors selling out of property during that time. This leaves pooled UK property funds vulnerable to a loss of investor capital at significant scale. For pooled property funds to remain successful, or even viable, over the longer term, fund managers will need other investor types to replace private DB schemes, but this is likely to prove challenging. The risk is that the buyers of property may not be looking to own UK property through unleveraged, open-ended, pooled, balanced funds. Some options are:

- **Local Government Pension Schemes (“LGPS”)**

The LGPS (and other public sector investors) also own c30% of units in balanced UK property funds. This capital is thought to be “stickier” as these schemes remain open to future accrual and are likely to maintain their allocations to growth assets over the long term. However, there is the potential risk of balanced funds losing some LGPS capital to asset pooling initiatives and/or to other types of property strategies, e.g. if there is a greater push to invest LGPS real estate portfolios on a more global basis, or to direct more investment to Residential or other specialist strategies (e.g. impact investments). LGPS funds are perhaps among the most likely investors to take advantage of the current discounted pricing of UK balanced property funds, being most “ready” to step in.

- **Defined Contribution (“DC”) Pension Schemes**

DC investors currently account for a very small proportion of UK balanced property funds and there is certainly an opportunity to grow the DC investor base substantially. There are frictions, mostly in relation to fund structures (e.g. the requirement for daily dealing) and availability of funds on DC platforms, that have slowed the growth in DC investment into UK property. There are several developments, e.g. fast-growing Master Trusts and the potential for platforms to become more accommodating for illiquid funds, which we expect to influence the UK DC market's ability to allocate more to property assets. We expect multi-asset and multi-alternative fund managers to be in a better position to facilitate the wider adoption

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of illiquid assets, and thus more likely to benefit from these developments than standalone specialist property fund managers.

- **Foreign capital**

Before 2023, most of the UK balanced property managers had done little to no marketing overseas despite at least half of the balanced funds in the index being available to foreign capital. We are aware of some managers increasing their marketing efforts last year in an effort to attract more foreign capital to replace the UK private sector DB pension schemes that are no longer allocating to property. It will be interesting to see how this develops over the next few years. Foreign investors have been buying UK commercial property for many years but not typically through unlevered, open-ended pooled funds (e.g., large sovereign wealth funds will often have a direct mandate to give them greater control over their investments). Property investment is typically levered in other regions, or in closed-ended fund structures, and foreign investors may be looking to replicate that when investing in the UK property market going forward. Other investors may prefer sector-specialist investments rather than funds investing across multiple sectors, or to make investment on a pan-European basis.

Outlook for open-ended pooled UK property funds

Overall, there are likely to be continuing limits on future capital flows into UK core balanced property funds and we do not expect all of the funds in the index to survive over the longer term. An alternative solution may be for smaller funds to merge with others or more likely, a larger fund may look to take over a smaller fund to maintain scale. Further, core fund managers may adapt and focus more on compelling investment opportunities rather than offering broad market diversification.

Without increased inflows from DC, wealth management or foreign investors, UK balanced property funds are likely to be less liquid, more costly, and less able to rebalance their portfolio weightings in the future.

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Investing in Leicestershire Programme

PORTFOLIO MANAGEMENT STRATEGY

2024/2028



FOREWORD



Lee Breckon

Lead Member for Resources Leicestershire County Council and Chair of the Investing in Leicestershire Programme Board

With a strong track record in owning and managing a diverse portfolio of property and other investment assets, we are proud to have a proactive approach to investment, especially against the backdrop of continued tight financial settlements from central government.

Investments have created a number of jobs and business opportunities which has stimulated the local economy. Going forward our goal is to continue this positive economic impact along with maintaining a portfolio which is environmentally sustainable and builds towards the goal of being a net zero county.

Our sensible, strategic and careful way of investing has led to a significant increase in the value of our Investing in Leicestershire Programme portfolio, which is in turn providing millions of pounds for services as you will read in this strategy.

The importance of investing taxpayer's money safely and wisely is a priority, and this strategy will work to ensure that our portfolio continues from strength to strength in the coming years and help to ensure our continued strong and resilient foundation to our property holdings



Declan Keegan

Director of Corporate Resources

This Investing in Leicestershire Programme is important in providing land and buildings for jobs and regeneration, and our investments have also seen us benefit from a healthy return on the assets we own.

Leicestershire County Council has always invested in a prudent and careful manner. This approach protects the portfolio's value as well as boosting the local economy and, importantly, generates a vital and sustainable income for front line council services.

Not only will this strategy support the council's Medium Term Financial Strategy (MTFS) objectives but will also support our other strategic objectives and goals for the council, including economic development and opportunities for investment in green infrastructure.

TABLE OF CONTENTS

1. Introduction	4
2. Strategic Objectives	5
3. Legal Context	7
4. Portfolio Management Strategy 2024 to 2028	8
5. Investment Criteria	11
6. Environmental, Social Governance (ESG)	13
7. Financial Returns	15
8. Investment Assessments	20
9. Risk	23
10. Risk Summary	27
11. Performance Monitoring/ Benchmarking	28
12. Staff Resources	30
Appendix A	31

Updated January 2024



INTRODUCTION

- 1.1 Leicestershire County Council (the Council) owns and manages property and other investments, some of which generate income that support front line services whilst contributing to the wider strategic objectives of the Council and the economic wellbeing of the area. This portfolio (the Portfolio) forms part of the Investing in Leicestershire Programme.
- 1.2 The Portfolio which is now reaching its target level of investment has grown significantly in value in recent years and provides a means by which the Council can continue to deliver high quality services to and add social and economic value for the people of Leicestershire despite the ongoing pressure on public finances. In addition to its wider social dimension, income generated by the Portfolio has reduced the amount of savings required to be made, and the impact on service provision to residents and businesses in the County which might otherwise have been adversely affected.
- 1.3 The Portfolio Management Strategy for 2024 to 2028 (the Strategy) is aimed at supporting the further development and ongoing management of the Portfolio to further enhance its contribution to the delivery of strategic goals whilst continuing to improve the Council's financial resilience as demand on services and operating costs continue to rise. It outlines how the Council will look to direct investments during this period developing the Portfolio to address areas of specific economic or social market failure and how it will manage the portfolio to help achieve the strategic priorities of the Council.
- 1.4 Whilst a key priority is to continue to deliver positive outcomes for the Council from its investments, the Strategy sets out processes to ensure this is done in a transparent and safe and secure way, ensuring adequate liquidity should the Council ever need to call upon the capital invested, that risks are properly identified and managed and that performance is monitored continuously.
- 1.5 The Strategy for 2024-28 includes reference to indirect and non-property investments. This diversification is an important component in financial risk management.
- 1.6 The Strategy is an integral part of the Council's Medium-Term Financial Strategy (MTFS) and intrinsically linked with the Corporate Asset Management Plan (CAMP) and the Treasury Management Strategy and Annual Investment Strategy and it should be read in conjunction with these documents.
- 1.7 The Council is committed to ensuring the Portfolio provides effective and efficient assets which enhance the environment and biodiversity in the county where possible and improves the lives of communities in the county whilst generating secure, long term, income streams that allows the existing investments to assist the Council in delivery of its front-line services.



STRATEGIC OBJECTIVES

2.1 The aims of this Strategy have been aligned with the five Strategic Outcomes set out in the Council's Strategic Plan (below) which will play a key role, alongside the Medium-Term Financial Strategy, in shaping the Council's investment activities over the next four years.

Strategic outcomes



Clean and Green

- People act now to tackle climate change
- Nature and the local environment are valued, protected and enhanced
- Resources are used in an environmentally sustainable way
- The economy and infrastructure are low carbon and environmentally friendly



Great Communities

- Diversity is celebrated and people feel welcome and included
- People participate in service design and delivery
- Communities are prepared for and resilient to emergencies
- Cultural and historical heritage are enjoyed and conserved
- People support each other through volunteering



Safe and Well

- People are safe in their daily lives
- People enjoy long lives in good health
- People at the most risk are protected from harm
- Carers and people with care needs are supported to live active, independent, and fulfilling lives



Improved Opportunities

- Every child gets the best start in life
- Every child has access to good quality education
- Families are self-sufficient and enabled to be resilient
- Everyone is able to aim high and reach their full potential



Strong Economy, Transport and Infrastructure

- There is close alignment between skill supply and demand
- Leicestershire has the infrastructure for sustainable growth
- Leicestershire is an attractive place where businesses flourish
- Economic growth delivers increased prosperity for all
- Leicestershire has the right homes in the right places to meet needs

2.2 The specific aims of this Strategy are to ensure investments funded or held in the Portfolio:

- Support the objectives of the Council’s MTFS, Corporate Asset Management Plan, Strategic Plan, its Economic Growth Plan and the County-wide Local Industrial Strategy.
- Support growth in the county and its economic area of influence and ensure there is a more diverse range of properties and land assets available to meet the aims of economic development.
- Maximise returns on Council owned property assets
- Supports the delivery of front-line services through increased income generation from existing investments, or through capital investments that will reduce operating costs.
- Maintain a diverse portfolio of energy efficient and sustainable direct property and other investment assets which support economic growth and environmental sustainability
- Support the Council’s strategic objectives by working with partners to maintain momentum in the development of strategic sites and renewing existing employment sites and premises where there is demand thereby addressing areas of market failure.
- Contribute towards the development and implementation of the Council’s Net Zero Carbon ambitions by reducing demand for energy and increasing the generation and use of renewable energy
- Channelling new investment into schemes that:
 - Maximise the potential to address economic and social market failure;
 - Improve property assets for a direct strategic/policy purpose
 - Enhance the value and marketability of property assets enabling capital receipts to be used to support improved service delivery
 - Manage investment risk by investing in diverse sectors.
- Support the Council in maximizing the benefit from its financial assets in a risk aware way (not including standard treasury management activity)¹

¹ Treasury Management activity with banks, local authorities and the capital market are not in the scope of this Strategy, such activities being undertaken in accordance with the Treasury Management Strategy and Investment Strategy agreed annually by the County Council.



LEGAL CONTEXT

- 3.1 Section 12 of the Local Government Act 2003 (the 2003 Act) provides a general power to invest:
- “(a) for any purpose relevant to its functions under any enactment or
(b) for the purposes of the prudent management of its financial affairs”*
- 3.2 The power contained in Section 12 (a) cannot be used for investing purely to create a return as this is not considered to be a purpose relevant to the Council’s functions whereas the power in Section 12 (b) may be used for investing to create a return as it may be prudent when used with other measures to manage the Council’s financial affairs.
- 3.3 Section 120 of the Local Government Act 1972 (the 1972 Act) provides the power for the acquisition of land by agreement (whether inside or outside the authority’s area) for the purpose of:
- “Any of their functions under this or any other enactment, or the benefit, improvement or development of their area”*
- 3.4 Acquisition can take place notwithstanding that the land is not immediately required for that purpose.
- 3.5 Further power is conferred upon an authority by the Localism Act 2011 (the 2011 Act). Section 1 of this Act introduced a new General Power of Competence which gave local authorities the power to do anything that individuals generally of full legal capacity may do. This Act is widely drawn and includes reference to commercial activities which do not necessarily have to benefit the local authority’s area. However, this power is subject to a requirement that any actions being carried out for a “commercial purpose” must be done “through a company”, (i.e., a company within the meaning of s.1 (1) Companies Act 2006).
- 3.6 The approach of the County Council to date has been to rely on the powers set out in the 2003 Act. At present, this has not required the setting up of a company for its property and non-property investment activities. However, it could be necessary in the future, if the Council wishes to expand and diversify the scope of its investments. Such arrangements are not detailed in this Strategy at this stage.
- 3.7 The Strategy should be read in conjunction with the Capital Strategy, Treasury Management Strategy, the CIPFA Prudential Code and Annual Investment Strategy and taken together take into account the statutory guidance issued by the Secretary of State under the Local Government Act 2003.

PORTFOLIO MANAGEMENT STRATEGY 2024 TO 2028

- 4.1 This Strategy is a high-level summary of the Council's approach to new investments. It sets out the criteria and the processes and practices that will be considered and followed when carrying out such activities.
- 4.2 The Strategy developed for 2024 to 2028 has been aligned with the Council's MTFS timetable and reflects the aspiration of the current Capital Programme to invest in assets that will secure a long-term economic and social benefit. It is designed to provide a framework that is flexible enough for the Council to participate in the property market whilst ensuring governance processes are in place, full assessments are made, and risks are minimised.

Purpose of the Portfolio

- 4.3 The primary purpose of the Portfolio will be to:
 - 4.3.1 develop new or existing assets to meet Council service needs where this will reduce operating costs or, for example, meet local housing needs, thereby securing benefits for the Council;
 - 4.3.2 continue to acquire both parcels of land for development and standalone direct property investments that contribute to the attainment of policy goals or address areas of economic or social market failure;
 - 4.3.3 continue to make better use of underperforming investment assets already owned by the Council, to redevelop these where appropriate to ensure they meet the needs of local businesses, meet current market expectations and address areas of market failure;
 - 4.3.4 maintain progress in the restructuring and rebalancing of the property portfolio
- 4.4 The Portfolio will also utilise Treasury Management investments to provide diversification to the overall portfolio, subject to any associated risks being monitored and managed. This is likely to include investments in different sectors, assets classes and geographies
- 4.5 The Portfolio will be reviewed, and performance of individual investments assessed on a regular basis. Where performance of an investment cannot be improved to an acceptable level, this will be disposed of. The sale proceeds from such disposals will either be reinvested or used to reduce borrowing in accordance with Government guidance.



Development of the Portfolio

- 4.6 The amount invested in the Portfolio as at 31 March 2023 was £217m. The latest valuation of the portfolio, as at 1st April 2023, which includes capital growth in the valuation of the assets held is £233m from which, based on the 2023/24 return, an annual contribution of approximately £5.8m per annum was derived. The value of the Portfolio is forecast to increase further by 31st March 2024 as underlying growth (capital growth) is achieved on the value of the assets.
- 4.7 An overall target return for the Portfolio's existing portfolio is 7%, reflecting the related risk, made up of a combination of capital growth and revenue income.
- 4.8 Decisions on how the investment programme is funded will be defined by the Council's Treasury Management strategy and considered as part of the MTFS.
- 4.9 A total fund of £217m is forecast to be held by the end of 2023/24. Over the MTFS period the following changes have been included:
- £59m – additional investment in MTFS 2024-28 capital programme (excluding general improvement investment)
 - (£9m) – sale of direct property held and pooled property funds
 - (£8m) – net change in maturing indirect investments held
- These will bring the total held to £260m (based on historic cost). Annual income returns are estimated at around £8m for 2023/24 and are forecast to increase to £10m by the end of the MTFS period (and higher in later years), contributing ongoing net income for the Council. A satisfactory business case appraisal which includes external due diligence will be required before each purchase or investment.
- 4.10 The County Council has not and does not intend to borrow to fund the investments within the Portfolio's development programme. The proposed investment included within the MTFS 2024-28 is entirely funded from revenue reserves. Decisions on the availability and proportionality of funding to fund the Capital Programme, are made through the Capital Strategy are reviewed annually as part of the MTFS, and the Treasury Management Strategy Statement and Annual Investment Strategy. These documents take into account the statutory guidance issued by the Secretary of State under the Local Government Act 2003.



Portfolio Management

- 4.11 As the portfolio nears its target level of investment its ongoing management needs to be both focused and proactive in order to ensure that opportunities to enhance the financial, economic development and community benefits are maximised. Accordingly, there is a need to regularly review and refocus the objectives and management strategies of each sector to reflect and meet the Council's policy agenda and provide strategic direction to future management plans and investment decisions; the process being supported by accurate management information and benchmarked data and evaluated against robust performance targets.
- 4.12 It is proposed that a full review of the Rural Sector portfolio of farms be undertaken in 2023/24 following the earlier external review of the rural portfolio's management and reflecting the advice and recommendations of the latest strategic review of the whole portfolio.



INVESTMENT CRITERIA

- 5.1 When investing the Council's financial resources action will be taken to ensure: -
- That principal sums invested are safeguarded as far as possible;
 - That they provide adequate liquidity;
 - That investment returns (or yield) are considered and balanced against potential risk factors.

- 5.2 Once liquidity (the ability to ensure (as far as is practicable) that should the Council wish to divest itself of an asset, it can do so without incurring any material loss) has been confirmed, the following criteria will be considered as appropriate when assessing a potential investment (including developments):
- Security of the principal capital to be invested (both for land acquisitions and development/construction proposals);
 - The ability of the investment to make a positive contribution to attainment of strategic objectives or addressing areas of market failure;
 - The financial return commensurate with the risk being taken, under a range of economic scenarios (market conditions, repairs etc.) Any legal issues (restrictive covenants etc.) regarding the title of the land/ property;
 - Risk of securing planning permission, including conditions
 - Any potential liabilities (such as land contamination/asbestos);
 - Sustainability (the energy performance of any existing property and its use);
 - Full cost of the acquisition (land value, fees, end of life costs etc.);
 - Fit with the current portfolio;
 - Exit strategy.

In addition, any property investment opportunities will also be considered with regard to:

- **Economic Benefit:** The number of jobs and business opportunities created/ supported and the ability of the asset to address market failure are the key elements of a potential investment together with the level of Gross Value Added to the economy
- **Development potential income:** The total income assuming the site is fully developed (with cash flow timescales) and the restrictions on use of the funds e.g., requirement to be recycled into further such schemes/investments.
- **Tenant:** The financial standing and viability of any existing (or potential) tenants' covenants is to be considered.
- **Location:** More weighting is given to acquiring assets or land/or the development of property assets in an area of the county requiring regeneration in order to maximise benefits by stimulating the local economy through sustainable financial and economic growth, over the lifetime of the investment.



- **Sector:** The strength of the investment or development sector should be considered in relation to its location, rather than in isolation.
 - **Building:** The age and construction of any existing buildings should be considered in the decision-making process. This should include how energy efficient the building/s is/are. The potential for future structural repairs, retrofits and refurbishment expenses for both the County Council and the occupiers should be limited as much as possible. Property let on a term which exceeds the economic life expectancy of the buildings should not be purchased.
- 5.3 Once an asset/investment opportunity has been identified, it should be considered as objectively as possible to ensure that the overall aims of the Strategy are achieved in a co-ordinated and measured way.
- 5.4 The adequacy of the estimated benefits will be judged against the certainty of the anticipated outcomes materialising.



ENVIRONMENTAL, SOCIAL GOVERNANCE (ESG)

- 6.1 In 2018 the County Council adopted a new environment strategy ('Environment Strategy 2018 - 2030 – delivering a better future') which contains the following commitment:
- "The UK Government's recent Clean Growth Strategy underlines the role that local government has in delivering and supporting our evolution to a low carbon society as we respond to these national and international commitments. The urgent need for concerted international action on climate change has been recognised by over 170 countries globally.*
- 6.2 The Paris Agreement of 2015 requires countries to work together in limiting global temperature rise to below 1.5 to 2°C, the recognised level established by the Intergovernmental Panel on Climate Change to limit the risks and impacts of climate change. The interconnection between economic development, social equity and inclusion and environmental impacts has also been recognised internationally via the 2030 Agenda for Sustainable Development. In recognition of this the County Council has signed up to UK 100 which commits the Council to achieving 100% clean energy by 2050."
- 6.3 Furthermore, in May 2019, County Councillors unanimously backed a motion calling for more to be done by the authority to cut pollution and declared a climate emergency.
- 6.4 To align with the council's wider ambitions the Fund will aim to ensure that its developments will be built in as sustainable a manner as possible with the aim of being net zero carbon in the construction phase and as energy efficient to occupy and operate as possible (including the use, where viable, of on-site renewable energy sources).
- 6.5 A net Zero Strategy will be developed and implemented for the whole portfolio containing the following provisions:
- a Quantify the portfolio's emissions on a sector basis to establish a baseline position.
 - b Set a trajectory for each sector with a view to achieving Net Zero within the corporately agreed timescales with targets incorporated within all future management plans



- c In respect of direct property sectors the strategy shall contain the following elements
- **Commercial property** - retrofit and energy efficiency, renewable energy generation, links to MEES regulations
 - **Rural** - transition plans for farms, renewable energy generation
 - **Developments** - supply chain engagement, materials guide, low carbon construction
- d Sustainable procurement guides, a net zero decision making matrix and an emissions offset policy shall be developed as part of the strategy together with appropriate KPIs monitoring and reporting
- 6.6 Furthermore, the developments will achieve net biodiversity gain and also push waste up the Waste Hierarchy by adopting a reduce, reuse, recycle approach to the management of waste particularly during the construction phase.
- 6.7 The wider public health agenda issues such as obesity, mental health, general health and wellbeing will also form part of the decision-making criteria as to what makes a good development design and layout. When deciding how and where to invest, the County Council is cognisant of the economic, social and environment considerations and will seek to ensure that any development it is involved with is a sustainable development.
- 6.8 The County Council will ensure that the relevant environmental, social, and governance (ESG) standards are met when seeking to screen potential investments.
- Environmental criteria will be used to consider how the County Council performs in its responsible use and protection of the natural environment through conservation and sustainable practices to enhance ecosystem resilience and human well-being.
 - Social criteria will examine how it manages relationships within the communities around the county where the County Council owns assets.
- 6.9 Governance criteria will ensure that the controls and processes for the Fund are appropriate and followed.



FINANCIAL RETURNS

Yield

- 7.1 Whilst it is intended that future investments should be judged primarily on the basis of the County Council's wider policy objectives; it is important to ensure that the financial performance of the assets held is acceptable.
- 7.2 The level of yield required balances security and liquidity. The term 'yield' can be defined as:
- "The annual rental income on an investment, expressed as a percentage of the capital value"*
- 7.3 For example, the annual rent received on a property investment is currently £50,000 per year gross. If the property has been valued at £1,000,000 then the revenue yield is 5%:

$$\text{Yield} = \frac{\text{Annual Rental Income}}{\text{Capital Value}} \times 100$$

$$5\% = \frac{(50,000/1,000,000)}{\times 100}$$

- 7.4 However, in addition there is also the potential capital growth which reflects how the value of an asset changes over time. If, for example, the value of the £1,000,000 investment had risen to £1,025,000 by the end of the first year; this would give capital growth of 2.5% and a combined gross investment return of 7.5%
- 7.5 The yield figure will reflect the various risks involved in the investment. By and large, the higher the level of uncertainty (e.g., a tenant with a poor credit rating) the higher the required yield would be.
- 7.6 The average/balanced target rate of return for investments made is 7% nominal. There will be costs incurred in managing the Portfolio and also costs associated with abortive work (feasibility studies, consultant work/staff time unsuccessful acquisitions bids).
- 7.7 Individual lot sizes can each be considered on their merits as long as they conform to the agreed overall portfolio mix.
- 7.8 Assuming that investment/development property is the only asset class of investment that is being considered, the overall return of a standalone investment will vary depending on the market sector, the nature of the property asset acquired and the characteristics of the tenant in the acquired property.
- 7.9 Whilst aiming for a return of 7%, the Portfolio will seek to invest in assets that guarantee at least a market yield in order to manage future risk by securing a return on investment attractive to the market.

Internal Rate of Return

7.10 Whilst yield is a useful measure for assessing the merits of an investment, yield will change over the life of an investment. To give a longer-term perspective, the Internal Rate of Return (IRR) is the key metric that is used to assess the strength of an investment. The IRR is the interest rate at which the net present value of all cash flows arising from an investment is equal to zero. In calculating an estimated IRR, a number of assumptions need to be made in terms of projecting future expenditure and income streams including the future capital value of the investment holding. As a guide a minimum IRR of 7% is a high-level assessment for whether an investment is worthwhile.

Independent Review

7.11 It is proposed that the performance of the Portfolio and the overall Strategy should be subject to an independent review at no greater than 3-year intervals. The first such review was undertaken in December 2020. As three years have now elapsed since the last review a similar review of the Portfolio was commissioned from Hymans Robertson in late 2023.

7.12 The 2020 Hymans Robertson strategy review made recommendations in respect of the portfolio distribution (by value) as set out in the following table.

Asset Class	Value at 31 March 2020	% of Total Fund	Strategic Recommendation (Hymans Robertson Dec. 2020)
Direct Portfolio (inc. Dev.)	£125.8m	73.6%	
Direct Portfolio (Exc. Dev.)	£67.0m	39.2%	
Offices	£27.2m	15.9%	Maintain or reduce
Industrials	£12.4m	7.3%	Increase
Distribution	£0.5m	0.3%	Increase
Rural	£22.5m	13.2%	Maintain or reduce
Other	£4.4m	2.6%	n/a
Development	£58.8m	34.4%	n/a
Residential Property	-	-	New Allocation
Pooled Fund Portfolio	£45.1m	26.4%	
Property (Core Commercials)	£24.8m	14.5%	Decrease
Private Debt	£20.3m	11.9%	Maintain or reduce
Residential Property	-	-	New Allocation
Infrastructure	-	-	New Allocation
Total	£170.9m	100.0%	

7.13 Since publication of the Hymans Robertson report in December 2020, the County Council has not acquired any new direct property investments. However, it has completed the Armstrong Building (LUSEP) and the developments at Airfield Business Park and Apollo Court. Except for the office asset class, the value of which has been significantly boosted by the completion and occupation of the Armstrong Building, the distribution by value of the remaining asset classes has broadly followed the strategic recommendation set out in the report; the influence of individual sectors being determined by market adjustments rather than transfer of assets or acquisitions.

7.14 The current position is set out below:

Asset Class	Value at 31 March 2023	% of Total Fund	Movement in fund since December 2020
Direct Portfolio (inc. Dev.)	£158.1m	67.7%	
Direct Portfolio (Exc. Dev.)	£111.9m	47.9%	
Offices	£53.1m	22.7%	Increased
Industrials and Distribution	£30.0m	12.8%	Increased
Rural	£24.2m	10.4%	Decreased but value maintained
Other	£4.6m	2.0%	Decreased but value of existing assets increased
Development	£46.2m	19.8%	Assets increased in value on grant of planning permission
Residential Property	-	-	
Pooled Fund Portfolio	£75.4m	32.3%	
Property (Core Commercials)	£22.5m	9.6%	Decreased but existing assets retained
Private Debt	£28.7m	12.3%	Maintained
Residential Property	-	-	
Pooled Infrastructure	£8.7m	3.7%	New Allocation
Pooled Bank Risk Share	£15.5m	6.6%	New Allocation
Total	£233.5m	100.0%	

7.15 Whilst the increase proportion of the fund within the Offices asset class appears to depart from the Hymans Robertson advice, the 2020 review was undertaken with the knowledge of the development pipeline at the time due to bring forward the Armstrong Building, and the intention that this asset would be retained. However, no further office investment is proposed at the present time. Similarly, the Airfield Business Park and Apollo Court estates moving into the Industrials asset class accounts for the major part of the uplift in the Industrial class, which will be further strengthened on the completion of the final phase of the Airfield Business Park

- 7.16 The proportion of the portfolio held in the development sector has increased over the past year due solely to the increased value of assets attributable to planning permissions granted over the period. As assets are sold or transferred the value of the sector will revert to a much lower level
- 7.17 The previous increase in value of the Property (Core Commercial) class which reflected a deliberate action to delay withdrawal of capital in response to the delay in the call for investment in the agreed Infrastructure fund has now been off-set by the infrastructure investment proceeding. Whilst, the withdrawal of capital from the Core Commercial's fund has yet to be actioned market adjustments have decreased its overall proportion of the fund.
- 7.18 The Private Debt funds have been maintained at 2020 levels as recommended by Hymans Robertson and whilst the recurring maturation of these funds allows for ongoing investment and provides a stable income no significant additions have been made to the portfolio.
- 7.19 The 2024 Hymans Robertson Review, as with the earlier 2020 Review, considered the current economic outlook and that of the real estate investment market. Based on the make-up of the portfolio as at 31st March 2023 the review concludes that the current portfolio mix of approximately 67% direct property and 33% diversifiers is appropriate and strikes a reasonable balance between the positive economic, social and environmental impacts generated in the direct portfolio and the downside protection provided by the diversifiers portfolio.
- 7.20 Given the volume of new investments to be made, it is anticipated that the direct portfolio will see only modest growth. The review recommends that the Council explores opportunities to dispose of certain existing assets and recycle the capital into new developments. This will enable the Programme to maintain a high level of positive impact in the local community, as well as providing the opportunity to implement some of the portfolio refinements proposed below.
- 7.21 In addition, the review acknowledges that the development sector, at 29% of the direct property portfolio, is currently significantly larger than would normally be anticipated. The disposal or future development of assets within the sector will correct the balance.
- 7.22 Further, the review in considering the future direction of investment strategy makes the following recommendations:-
- In respect of the Direct Property Portfolio
 - Increase the allocation to the Industrial/Logistics sectors
 - Maintain or reduce the allocation to Offices
 - Selectively consider Retail investments
 - Maintain the Rural allocation
 - Increase the allocation to other Alternative sectors
 - Cap the allocation to Residential



The review also considers that local infrastructure assets are potentially attractive additions to the Fund's direct portfolio, offering a good income yield, potential diversification and clear economic and environmental benefits

- In respect of the Diversifiers
 - Allow the allocation to pooled Property to fall but ideally not below 25%
 - Maintain the allocation to pooled Infrastructure
 - Increase and diversify the allocation to pooled Private Debt

7.23 The review does not recommend any major changes of direction. However, it does suggest that within the direct portfolio consideration be given to selected retail investments and recognises the potential for investment in local infrastructure assets. In the case of diversifiers it advises that the portfolio be rebalanced reducing the level of pooled property and maintaining the level of pooled infrastructure investments whilst increasing and diversifying the portfolio of private debt investments.

7.24 Accordingly, future management and investment strategy and decisions will be influenced by the Hymans Robertson review with the above advice used to inform all future investment decisions forming an integral part of investment assessments which will continue to be supported by full business cases



INVESTMENT ASSESSMENTS

- 8.1 This Strategy places emphasis on openness, transparency and consistency. It aims to ensure maximum benefit from the effective purchase and subsequent management of the Council's assets, but within a framework which can be adaptable to market conditions. Within this framework, the Council must act within the appropriate legal framework, in a demonstrably fair and open manner, and consider whole life costs.

Direct Property Investments

- 8.2 Each proposed direct property investment proposal (including both proposals to acquire and/or develop property) will be subject to a three-stage appraisal process as detailed below, although given the need to respond quickly to opportunities as they become available, a degree of flexibility is required and some of these stages may be combined.

STAGE 1 - Initial Assessment

- 8.3 The first phase of determining whether a direct property investment opportunity is worth proceeding with consists of a number of separate assessments:
- Fit with other Portfolio holdings
 - Fit with County Council priorities
 - Risk Profile
 - High level financials (revenue and potential for capital growth),
 - Tenancy Terms
 - Planning Overview
 - Site Inspection
 - Legal considerations and fit with statutory guidance
 - Valuation
- 8.4 Strategic Property Services will first prepare an Initial Appraisal Report (IAR) which is intended to answer the basic question – 'is the asset worth acquiring?'
- 8.5 The IAR considers the likelihood of the proposed investment achieving the outcomes required, the size and barriers to entry of the market, plus its suitability to the Council's own ethical standards, the quantum of risk and complexity, the payback period and how much the Council knows about the proposal (i.e., are there just too many unknowns?). Initial basic property details are also recorded at this time.
- 8.6 The answers to these key points will give a simple yet effective picture of the proposal and will allow an early decision to be made by the Director of Corporate Resources as to whether an investment is worth pursuing.

- 8.7 The process is run by the Strategic Property Services team and the decisions summarised in a regular report to the Director of Corporate Resources.
- 8.8 A challenge can be raised through the Strategic Property Services team, ultimately to the Director of Corporate Resources, but there must be no multiple consideration of the same proposal during the initial process. Once it has been deemed a failure, unless there is a fundamental error in the data provided or a paradigm shift on the proposal itself then the activity must cease.

STAGE 2 – Financial Appraisal and Business Case

- 8.9 Once the asset/site has passed the initial evaluation, a financial appraisal and business case will be prepared to establish the financial/budgetary implications of acquiring the property at the negotiated price.
- 8.10 An independent property advisory firm will also be consulted on the opportunity and their report made known to the Investing in Leicestershire Programme Board (the Board) if the proposal is progressed beyond stage two.
- 8.11 The aim of the financial appraisal is to assess how the acquisition will perform. It will consider all the acquisition costs and any potential income, the associated risks and then assess whether the asset is a suitable acquisition from financial perspective. The business case will also develop the non-financial benefits that are being sought from the acquisition. This process will be led by the Strategic Finance Service, but the Director and the Board will be kept advised as projects are assessed and negotiated.

Other Council Consultees

- 8.12 After the identification of an asset, it will be incumbent on Strategic Property Services as Portfolio Manager to establish whether there may be constraints on the development or use of the asset.
- 8.13 In some cases, it may be appropriate to seek planning permission for a form of development prior to acquiring land. Strategic Property Services will consult with planning and highways colleagues (and other departments as appropriate) together with external consultants to decide whether planning permission should be sought prior to acquisition (conditional contract).
- 8.14 As part of this consultation, advice will be sought on suitable alternative uses for the site/asset. In case the existing or proposed use becomes unviable in the future, it is useful to have an alternative use value. The relative monetary risk of the investment can be quantified using this information.
- 8.15 Contemporaneously with the planning audit, the Council's legal section will be asked to undertake title searches of the land to ensure that the title is clean and there are no abnormal issues with the land that would be detrimental from a legal perspective.
- 8.16 Any existing or proposed tenant will also be credit checked.



Valuation

- 8.17 Valuation advice will usually be provided by a professionally qualified member of the Council's Estates team. Where the advice required is particularly specialist or, if otherwise appropriate, valuation advice may be provided by another suitably qualified external surveyor.

STAGE 3 - Approval to Acquire/Develop

- 8.18 If the investment satisfies both stages one and two of the appraisal process, then on reaching agreement in principle as to the terms of acquisition, a detailed report will be prepared for consideration by the Board. Subject to the Board's support, acquisitions will then either be presented to the Cabinet for approval (necessary due to the size, complexity or risk (financial or reputational) of the proposed investment) or will be progressed by the Director of Corporate Resources under delegated powers. This report will set out how the acquisition is in accordance with agreed Council priorities and this Strategy.
- 8.19 Each business case will be approved by the Director of Corporate Resources (Section 151 officer) prior to presentation and discussion at the Board, which is chaired by the Lead Member for Resources.
- 8.20 All acquisitions shall have the necessary budgetary and relevant approvals before the acquisition is completed.
- 8.21 For clarity any decision that requires an approval of expenditure of less than £5 million can be made by the Director of Corporate Resources under the powers delegated by the Cabinet.
- 8.22 Any decision that requires an approval of expenditure of less than £100,000 (and is line with a previous approved budget/scheme) has been subdelegated by the Director to the Head of Strategic Property Services'.
- 8.23 Any decision that requires an approval of expenditure of more than £5m will require Cabinet approval.

Surveys and Instructions

- 8.24 When all appropriate surveys (which must include an asbestos survey where the acquisition involves a building erected prior to 1999) have been satisfactorily completed or provided, the Council's legal services team will be instructed to complete the documentation associated with the acquisition.

Other Investments

- 8.25 Other investments, such as into private debt, will be subject to approval as part of the Council's overall treasury management processes. Where this is outside of the Treasury Management Strategy approved by County Council this will include a specific report to Cabinet outlining the potential risks and benefits of the investment.



RISK

- 9.1 In respect of every investment there will be several risks that need to be assessed prior to a project being taken forward and then managed, mitigated and monitored throughout the life of a project. The key risks faced by the County Council in respect of its investment activities are set out below.

Investment Risk

- 9.2 The main risk with any investment lies with the ability to ensure the value of the original investment is maintained and safeguarded through securing an ongoing income stream.
- 9.3 For direct property, measures can be taken through, for example, ensuring that the tenant is of good covenant and is financially secure.
- 9.4 If the tenant defaults, then whilst there are procedures to recover the rent, this is not guaranteed and can be time consuming and costly.
- 9.5 There are also issues with voids (periods of time when the investment is not income producing but the asset is incurring costs such as insurance, security, business rates, repairs etc.).
- 9.6 The ability to attract tenants of sufficient quality/sound covenant will also be affected by the macro-economic situation and more regional/location factors.
- 9.7 Continuing to hold an element of the portfolio in treasury management investments helps to mitigate against these risks although there will always be a dependency on the overall economic situation, including specifically the prevailing interest rate.

Financing Risk

- 9.8 The Council is to ensure compliance with the Prudential Code for Capital Finance in Local Authorities and ensure liquidity and security of the principal capital and not to tie up resources into long term situations whereby short-term cash needs cannot be met or cannot be met without a significant financial penalty.
- 9.9 The returns generated by the Fund need to reflect the potential for the principal invested to reduce and for lost liquidity. A minimum total nominal return of 6.1% is sought in every investment (3.5% Green Book * 2.5% average inflation). This is reviewed (at least) annually for changes in the opportunity cost of the Council's resources (e.g., borrowing) and other factors such as inflation and returns available elsewhere.
- 9.10 Decisions relating to the financing of investment and/or development will be taken in conjunction with the Council's Treasury Management Strategy Statement and Annual Investment Strategy both approved each year as part of the Council's MTFS.

Reputational Risk

- 9.11 It is important that the reputation of the Council is protected during both times of financial restraint and otherwise in the investments that it makes.

Development Risk

- 9.12 This risk is specifically associated with developing property, and these are higher than those risks associated with acquiring an already built property investment. This is therefore reflected in the business case analysis.
- 9.13 Build cost over runs and delays during the pre and the main construction phases will directly affect the ability of the scheme to deliver its full economic benefits and (as above) the risk of not securing a tenant to pay the rent is higher when dealing with new builds.
- 9.14 This can be mitigated by not building speculatively but only with an identified need and potential occupier tenant already in place, legally secured through an Agreement to Lease. However, this may not always be the best strategy as some prospective tenants may wish to see the building in place first before entering into a contract. Each of these scenarios will be judged on a merit basis as they arise.
- 9.15 Officers will continue to keep the Director of Corporate Resources updated on projects to ensure that risks are monitored, eradicated or mitigated (or, in project management risk terms, the strategies to be employed are: treat, tolerate, transfer, terminate) where possible.

Managing Risks Direct Property Investment Appraisal Process

- 9.16 In order to minimise the risks associated with any investment being considered the Director of Corporate Resources will:
- 9.16.1 Consider the level of return required from the capital that is invested. Each proposal should review the liquidity of the proposed acquisition and a fully costed exit strategy should the asset underperform and is not capable of being improved.
- 9.16.2 Undertake a cost/benefit analysis to fully understand the likely returns, identify any hidden costs and include key metrics such as Expected Yield, Internal Rate of Return and Payback period.
- 9.16.3 Undertake a market analysis to ascertain the likelihood of the investment being required for and successfully delivering the desired economic and social outcomes across a full range of indicators.

- 9.16.4 Consider the use of external expertise where required to enhance the internal knowledge/ skills of officers and provide a greater level of assurance on the risks and mitigations involved, with the quality of the advice measured through the performance of each individual proposal against the benchmark/ target rate as set in the original business case and reported through to the Board regularly.
- 9.16.5 Produce a risk register for each property investment opportunity and update this annually. As each risk is analysed, a score which is a factor of probability and impact will be calculated (as per chart below) to ascertain the need for prioritising any actions to either tolerate, treat, terminate or transfer each particular highlighted risk..

		Impact (Negative)				
		Minor	Moderate	Major	Critical	
		1	2	3	4	
Probability	4	Almost Certain	Medium (4)	High (8)	Very High (12)	Very High (16)
	3	Likely	Medium (3)	High (6)	High (9)	Very High (12)
	2	Possible	Low (2)	Medium (4)	High (6)	High (8)
	1	Unlikely	Low (1)	Low (2)	Medium (3)	Medium (4)

- 9.17 The property investments will be considered as part of a diverse asset portfolio, to mitigate the risk associated with any single investment proposal. This diversification will include selecting a range of proposals with mixed payback, investment levels, returns, geographical locations, investment liquidity, specialist's skills and markets.

Fraud and Corruption

- 9.18 The Director of Corporate Resources will ensure that risks of loss through fraud, error, corruption or other such eventualities in its investment dealings are mitigated as far as is practicable and that these systems and procedures in place to tackle this are robust.
- 9.19 The Director and officers are alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, procedures for verifying and recording the identity of counterparties (e.g., tenants) will be maintained, as will arrangements for reporting suspicions, and ensuring that all members of staff involved in such dealings are properly trained.



- 9.20 Items that will be regularly reviewed as part of every transaction will include:
- 9.20.1 Powers to own property investments
 - 9.20.2 Money laundering risks
 - 9.20.3 Property fraud risks
 - 9.20.4 Changes to property legislation (e.g., Energy Act)
 - 9.20.5 Appropriate third party checks before transacting
 - 9.20.6 Due diligence in transactions
 - 9.20.7 Keeping abreast of impact of legislative changes
 - 9.20.8 Regular inspections of the assets
- 9.21 Full records of the purchase process will be kept in a separate file relating to the property and these records shall include details as to the valuation relied on in making the decision to acquire, the financial appraisal together with consents, approvals and papers recording the decisions taken under delegated powers. Such documents will form part of the public record.

Member and Officer Oversight

- 9.22 The Council will continue to ensure the prudent management of its investments and for giving priority firstly to the security of the capital.
- 9.23 The Council will continue to ensure that procedures for monitoring, assessing and mitigating the risk of loss of invested sums are robust. The Board, acting in accordance with the Terms of Reference approved by Council as part of the MTFS 2023 - 2027, will play a vital role in assessing investment proposals early on and thereafter monitoring projects and overall performance of the Portfolio.
- 9.24 Financial performance is monitored by officers and members on a regular basis. The Cabinet and the Scrutiny Commission will receive regular MTFS monitoring reports which include information on the operation of the Fund. These bodies also receive an annual report on investment activity undertaken during each financial year which also provides an update on ongoing projects.
- 9.25 Officers have continuous oversight of matters relating to property assets held for both service delivery and investment purposes. These are monitored through the Asset Management Property Group and the Corporate Property Steering Group chaired by the Director of Corporate Resources.
- 9.26 Effective management and control of risk are prime objectives in the management of the Fund. Any risk identified will form part of the managing departments Risk Register Which will be managed and mitigated and reassessed regularly in accordance with the Council's usual practice. Where appropriate, any significant risks will be captured on the Council's Corporate Risk Register which is overseen and monitored by the Council's Corporate Governance Committee.



RISK SUMMARY

- 10.1 The Portfolio is to acquire property/infrastructure investments (where investing creates the ability to address market failure or support another County Council objective), development sites (where the Portfolio will be involved in developing infrastructure, finding tenants and building schemes out with the same purpose in mind) and other property/strategic land (where there is an expectation of a future improvement and capital growth).
- 10.2 Indirect investments will be held for diversification purposes, this is expected to be restricted to pooled property, infrastructure, bank share and debt funds. The Portfolio is unlikely to acquire surplus operational property (that is being disposed of) where it has no potential to deliver future strategic outcomes.
- 10.3 The Council must consider its ability to divest; including the length of time and the ease and cost with which said investments can be returned in their entirety.
- 10.4 It is important for the Council to consider the key requirement of the Prudential Code which requires authorities not to tie up resources into long term situations whereby short-term cash needs cannot be met or cannot be met without a significant financial penalty. There must be a clear understanding and forecast of short-term cash needs which will need to be fully provided for by the Council before it considers longer term capital tie in.
- 10.5 This portfolio view, as well as individual asset classes, will be regularly reported to the Board, the Cabinet and the Scrutiny Commission.
- 10.6 Each individual proposal will have an exit strategy clearly articulated in the original business case which will provide an indicative timeline for the repayment of capital/ returning of funds once the decision has been made to divest, subject to market conditions.



PERFORMANCE MONITORING/ BENCHMARKING

11.1 CIPFA guidance states that: -

“Performance measurement is a process designed to calculate the effectiveness of a portfolios or managers investment returns or borrowing costs, and the application of the resulting data for the purposes of comparison with the performance of other portfolios or managers, or with recognised industry standards or market indices.”

11.2 It is clearly important to monitor performance to ensure that any judgements being made are the right ones.

11.3 The Portfolio is subject to regular revaluations – with a regular review of investment methods as well as the delivery models. This will also include a regular assessment of the credit worthiness etc. of its’s tenants.

11.4 It is the Council’s aim to achieve a stable long-term value for money from its investment activities. This will be through support to the County Council’s priorities whilst safeguarding the value and integrity of the initial investment and delivering financial returns commensurate with the level of risk undertaken.

11.5 As part of the performance reporting of the commercial programme the Board will consider not only new investment proposals, but also ongoing reporting of commercial activity outlining:

11.5.1 the performance of the portfolio,

11.5.2 the future pipeline of opportunities,

11.5.3 the investment forecast,

11.5.4 the risks and mitigations,

11.5.5 the detailed performance and commentary of each investment/development proposal within the portfolio.

11.6 The reporting will be effective enough to allow the Board to support decisions on the future of each investment proposal considering four key outcomes:

Increase - the proposal is performing well, and every indicator shows that the Council should increase the amount invested to generate enhanced benefits.

Continue - the proposal is performing well, and every indicator shows that the Council should continue with the existing levels of investment

Warning - the proposal is not performing well and should be closely monitored, and remedial action taken. If the proposals poor performance hasn’t been reversed The Board should consider alternate strategies

Exit/Disinvest/Stop - the proposal is not performing well, despite the Council’s best efforts, the proposal should be considered for closure as soon as practicable, and the exit strategy evoked.



- 11.7 The commercial approach of the Council must be considered against the wider CIPFA financial regulations and DLUHC guidelines.
- 11.8 Each investment made by the Council will need to be regularly valued as part of the year end accounts closure process, with different asset types requiring differing valuation methods and timings.
- 11.9 There will be an annual analysis of the portfolio mix and re-profiling of the portfolio. This includes the current estate as well as new acquisitions. There will be more regular reviews in changeable/volatile economic circumstances.
- 11.10 The Strategy should consider the Portfolio's exposure to both macro and local economic downturns and monitor financial market commentaries and reviews on the likely future courses of interest rates, exchange rates and inflation and their potential impact on the property market and yields.
- 11.11 The Strategy should allow sufficient flexibility both to take advantage of potentially advantageous changes in market conditions and to mitigate the effects of potentially disadvantageous changes.
- 11.12 Officers will report regularly to the Director of Corporate Resources and will provide an annual report to Cabinet and to the Scrutiny Commission as well as updates throughout the year.
- 11.13 Financial performance will be benchmarked against other organisations.
- 11.14 More financial technical benchmarks such as Expected Yield and Internal rate of Return are also used to provide accounting rigor regarding performance.
- 11.15 Other items such as total investment, risk profile, liquidity and exit costs for the individual activities above a certain threshold are summarised in the regular reports to The Board.
- 11.16 The Statutory Guidance on Local Government Investments (3rd Edition) which is issued under s15(1)(a) of the Local Government Act 2003 requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its decisions (para 22 of the Guidance).
- 11.17 Therefore, the Council has adopted the quantitative indicators as recommended by the Guidance (see Appendix A) and these, where appropriate, will form part of the Portfolio's annual report.



STAFF RESOURCES

- 12.1 The Portfolio is managed by the Head of Service with support from colleagues in Strategic Property Services with additional legal and consultancy advice. The Director of Corporate Resources will ensure that there are adequate resources employed to ensure the Portfolio is managed in a safe and productive manner.



APPENDIX A

Quantative Performance Indicators		Estimate 2022/23	Estimate 2026/27
Debt to net service expenditure (NSE) ratio	Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.	n/a	n/a
Commercial income to NSE ratio	Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.	1.49%	1.63%
Investment cover ratio	The total net income from property investments, compared to the interest expense.	n/a	n/a
Loan to value ratio	The amount of debt compared to the total asset value.	n/a	n/a
Target income returns	Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties.	3.51%	3.85%
Benchmarking of returns	As a measure against other investments and against other council's property portfolios.	6.01%	6.85%
Gross and net income	The income received from the investment portfolio at a gross level and net level (less costs) over time.	£10.5m	£13.8m
		£7.6m	£10.0m
Operating costs	The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.	£2.9m	£3.8m
Vacancy levels and Tenant exposures for non-financial investments (direct commercial property)	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.	5.0%	5.0%
		(40,700 sq. ft.)	(45,000 sq. ft.)
Amount of tenanted farmland disposed of vs acquired	Monitoring the size of the County Farm Estate.	26 acres sold vs	100 acres sold vs
		0 acres acquired (7,365 acres held)	0 acres acquired (7,150 acres held)
Number of tenant farmers	Monitoring how many farmers have taken leases on County Farms Properties with particular reference to new entrants to the farming sector.	4 new letting	2 new letting
		1 new entrant	1 new entrant
Note 1. No borrowing has been incurred to fund IILP			

