APPENDIX 3

CHELTENHAM BOROUGH COUNCIL – PROPERTY INVESTMENT FUND

OPTIONS APPRAISAL

The Options Appraisal considers the relative benefits and limitations of six investment options as follows:

1. Existing assets – direct investment
2. Existing assets – joint ventures
3. Property Fund
4. Risk share development – forward purchase/funding
5. Risk share development – joint venture
6. Self-develop

These are assessed against eight criteria:

- Corporate objectives
- Revenue generation
- Risk
- Control
- Liquidity
- Management oversight
- Performance
- Diversification

Increasing risk and returns
## Existing Assets – Direct investment

<table>
<thead>
<tr>
<th><strong>What is it?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- The Council acquires and manages freehold or leasehold properties e.g. Delta Place.</td>
</tr>
</tbody>
</table>

### How does it work?

<table>
<thead>
<tr>
<th><strong>Risk</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low risk option.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Control</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>High level of control.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Liquidity</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Reasonable liquidity, subject to usual property market timings.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Management oversight</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Relatively light requirement – high involvement at key decision points (buying and selling).</td>
</tr>
</tbody>
</table>

### LIMITATIONS

<table>
<thead>
<tr>
<th><strong>Performance</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low return option and no competitive market position.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Diversification</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Desired diversification unlikely to be achieved given current potential capital allocation.</td>
</tr>
</tbody>
</table>

## Existing Assets – Joint Ventures

<table>
<thead>
<tr>
<th><strong>What is it?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- The Council acquires and manages freehold or leasehold properties together with a partner council e.g. Airport.</td>
</tr>
</tbody>
</table>

### How does it work?

<table>
<thead>
<tr>
<th><strong>Risk</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low risk option – JV partner risk added.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Control</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium level of control.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Liquidity</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Reasonable liquidity, subject to usual property market timings and governance of JV.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Management oversight</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Light requirement – JV partner undertakes some of the direct acquisition, management and sales work.</td>
</tr>
</tbody>
</table>

### LIMITATIONS

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<th><strong>Performance</strong></th>
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<tr>
<th><strong>Diversification</strong></th>
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</thead>
<tbody>
<tr>
<td>Diversification improved given additional Partner capital contribution.</td>
</tr>
</tbody>
</table>
### Property Fund

**What is it?**
- The Council invests in property funds which own a range of diversified property investments.

**How does it work?**
- The Council will undertake a process of reviewing available fund options and the track record of the fund managers through its Treasury advisors.
- Once capital is invested the entire responsibility for acquiring and managing the investments is delegated to and the responsibility of the fund manager.
- The fund manager will report and pay distributions to the Council on a regular basis.
- The fund documentation will set out the rights of the Council to redeem its investment and/or to sell it on the secondary market. The nature of these rights will vary depending on the type of fund.

**Corporate objectives**
- Delivers CBC outcomes including economic regeneration benefits

**Revenue generation**
- Generates revenue from the time of the fund investment – although performance should increase over the longer-term. Depending on fund type, is capable of delivering annual return above current interest rates. Worst performing funds currently achieving 6.9%.

**Risk**
- Risk is determined by the nature of the fund. Additional risks relate to the fund structure, principally the performance of the fund manager.

**Performance**
- Returns are related to the specific investment strategy of the fund and manager performance.

**Diversification**
- Fund investment can spread risk over a large number of underlying assets.

**Control**
- High level of control of fund interest.

**Management oversight**
- Low return option and no competitive market position.

**LIMITATIONS**
- Liquidity
  - Unlisted investment funds generally have a low level of liquidity particularly in market downturns.

### Risk Share Development – Forward Purchase Funding

**What is it?**
- The Council enters into an agreement with a developer to fund part of the development cost and/or acquire a development on completion.

**How does it work?**
- The Developer will identify a market opportunity (although it may come from the Council) and carry out the development functions.
- The Council will be able to determine the risk profile it wishes to take on in entering the arrangement with the developer (e.g. after planning permission has been secured and construction packages have been tendered).
- During the construction stage the Council will likely require monitoring rights.
- Post development completion (as per direct investment):

**Corporate objectives**
- Delivers CBC outcomes including economic regeneration benefits

**Revenue generation**
- Should deliver a premium to pure investment activity, so at least a 6% income return dependent on property type.

**Performance**
- A higher level of performance than investment activity.

**Risk**
- The risk of development is highly mitigated by the forward purchase/funding arrangements.

**Control**
- High level of control.

**Management oversight**
- Moderate level once the transaction is agreed.

**LIMITATIONS**
- Revenue generation
  - Revenue can accrue to the investment when funded, but this will only occur during or at the end of the development period.
- Diversification
  - Desired diversification unlikely to be achieved given currently contemplated level of investment.
- Establish ongoing management arrangements (internal or outsourced)
- Regular asset reviews to determine business plan and exit strategy.

**Risk Share Development – Joint Venture**

**What is it?**
- The Council enters into a JV agreement with a developer/partner to carry out a specific development e.g. potentially Municipal Offices.

**How does it work?**
- The Developer will identify a market opportunity (although it may come from the Council) and carry out the development functions.
- The risk of the development will be shared 50/50 between the Council and the Developer/partner.
- The Council will be involved in key decisions during the development period.
- Post development completion (as per direct investment):
  - Establish ongoing management arrangements (internal or outsourced).
  - Regular asset reviews to determine business plan and exit strategy.

**BENEFITS**
- **Corporate objectives**: Delivers CBC outcomes including economic regeneration benefits
- **Performance**: A higher level of performance than investment and forward purchase/fund development activity.
- **Risk**: The risk of development is mitigated by careful partner selection and development stage oversight.
- **Control**: Strong level of control through JV documentation.
- **Management oversight**: Meaningful level of oversight required.

**LIMITATIONS**
- **Revenue generation**: Should deliver a premium to pure investment and forward purchase/funding, so at least a 5% income return dependent on property type. Revenue will only accrue once the development is completed and leased (or sold).
- **Diversification**: Diversification improved given Developer 50% capital contribution, but still unlikely to be at desired level.
- **Liquidity**: Low liquidity during the development period, thereafter as per the general property market.

**Self-Development**

**What is it?**
- The Council undertakes a development itself, appointing a development manager e.g. potentially shop-fitters site.

**How does it work?**
- The Development Manager will identify a market opportunity (although it may come from the Council) and carry out the development functions.
- The risk of the development will be taken 100% by the Council.
- The Council will be involved in key decisions during the development period.
- Post development completion (as per direct investment):
  - Establish ongoing management arrangements (internal or outsourced).

**BENEFITS**
- **Corporate objectives**: Delivers CBC outcomes including economic regeneration benefits
- **Performance**: The highest level of performance – the Council retains all development profit.
- **Risk**: The risk of development is mitigated by appointment of expert development manager and adoption of thorough risk management strategy.
- **Control**: Complete control with the Council.

**LIMITATIONS**
- **Management oversight**: High level of oversight required.
- **Revenue generation**: Should deliver a premium to pure investment and forward purchase/funding, so at least a 5% income return dependent on property type. Revenue will only accrue once the development is completed and leased (or sold).

**Liquidity**
- Low liquidity during the development period, thereafter as per the general property market.
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