

APPENDIX 1:

Property Scrutiny Group (PSG):
Terms of Reference



Membership

The Property Scrutiny Group (PSG) will comprise the following core group of directors and officers from North Hertfordshire District Council (NHDC):

- Service Director: Commercial (*Chair of PSG*).
- Service Director: Resources (*Deputy Chair of PSG*).
- Senior Estates Surveyor.
- Commercial Manager.
- Accountancy Manager.
- Contracts & Property Solicitor.

All members of the PSG will be required to:

- Read NHDC's Property Acquisition & Development Strategy, including appendices, prior to discharging their collective role.
- Where required, appoint external advisers with appropriate qualifications, skills and experience.

Role

General

The PSG will:

- Operate within these Terms of Reference.
- Conduct appraisals of property acquisition and development opportunities based on the principles, core goal and objectives of the Property Acquisition & Development Strategy.
- Make recommendations as to which opportunities to pursue and reject, again based on the Strategy.

All recommendations by the PSG require the agreement of a majority of NHDC officers forming the PSG.

Where there is no supporting majority among PSG members, the Service Director: Commercial shall arbitrate and his/her decision to pursue or reject a recommendation will be final. This Director reserves the right to consult on recommendations of the PSG with other NHDC directors, the Executive Member for Enterprise and Co-operative Development and the Executive Member for Finance and IT.

Production of business case

Where the PSG recommends pursuing an acquisition or development opportunity, the recommendation will be supported by a business case produced by the PSG.

As a minimum, the business case will assess the following:

- Results of due diligence conducted on each property opportunity, including the legal, financial, commercial and constructional circumstances and prospects of each property, and how this affects viability and the four fundamentals of property ownership. Due diligence must consider matters recorded in Land Registry title registers, deeds and terms of purchase.
- Transaction costs (e.g. purchase price, Stamp Duty Land Tax and professional fees).

- Ongoing capital costs of asset (e.g. costs of upgrading or repairing a building during the expenditure horizon, anticipated useful life or holding period).
- Ongoing revenue costs of asset (e.g. borrowing costs, management costs, running costs and holding costs during tenant voids).
- Affordability, including consideration of the Minimum Revenue Provision requirements.
- Opportunity costs of acquisition or development (e.g. the alternative options foregone by deploying capital and revenue on a particular asset).
- Security, liquidity and yield (yield considering transaction costs and any rental concessions).
- Proportionality of the acquisition or development relative to NHDC's existing property portfolio, its Investment Strategy and revenue budget, and how acquisition/development impacts risk exposure.
- Revenue generation and growth from an acquisition (rental income).
- Anticipated capital receipts and capital value movements from an acquisition (e.g. when sold on).
- Resources and expertise to manage acquisitions and developments to generate optimal outcome.
- Risk of loss to NHDC of entering into each property acquisition or development. This assessment should consider several variables throughout the expenditure horizon, anticipated useful life or holding period of the property, including:
 - Purchase price or initial capital outlay (including all directly attributable costs).
 - Fair Value movements and the security that Fair Value provides against loss.
 - Rent level projections.
 - Frequency and length of income voids, including rental concessions like rent-free periods.
 - Tenant financial health and risk of defaults.
 - Level of competition/supply from other schemes and influences on that supply, for example barriers to entry.
 - Tenant demand and influences on demand.
 - Maintenance costs.
 - Property taxes (including VAT).
 - Letting costs.
 - Costs of any borrowing - for example interest rate movements.
 - Management fees.
 - Future refurbishment, component replacement or reconfiguration costs.
 - Mitigation measures - for example tenant guarantors or rent deposits.

A sensitivity analysis to model the effect of movements in value and expenditure is recommended.

- Advantages and disadvantages of acquiring or developing property where the opportunity to do so is located *outside* NHDC's area.

Asset performance monitoring & assessment

The PSG is responsible for monitoring the performance of NHDC's assets following their acquisition or development. The PSG will agree and monitor performance targets and limits for each property and for the property portfolio. As a minimum, these should focus on achievement of the Strategy's objectives, together with focusing on security, liquidity and yield.

The PSG will assess the risk of loss before entering into, and whilst holding, property assets by cash flow modelling the income and expenditure profile of each asset.

This assessment requires continual monitoring of rental income and the lifecycle costs to maintain that income, in order to assess the ongoing security and yield of each asset. The ongoing revenue costs of each acquisition or development will be assessed against the asset's future projected revenue generation to ensure the acquisition or development can achieve the net minimum rate of return.

The PSG will subject the cash flow model to a range of stress tests to check the financial resilience of acquisitions or developments. The resilience will be influenced by the criteria set out in the Scoring Matrix outlined in the Property Acquisition & Development Strategy.

Performance of assets acquired or developed will be appraised and evaluated against benchmark purchases of other stakeholders active in the market, and against market research or commentary.

Fair Value measurements undertaken by the Senior Estates Surveyor and/or external advisers will form a component of the acquisition and monitoring process.

The Senior Estates Surveyor and/or external advisers will inform the PSG of changes in market conditions that pose a risk to the ongoing security, liquidity and yield of assets.

Reporting

All recommendations of the PSG to acquire a property or pursue a development will be reported to the relevant NHDC director(s) and/or NHDC Committee to obtain authority to proceed, in accordance with NHDC's Constitution.

After a property is acquired or development completed, the Service Director: Resources will record the following:

- The contributions each acquisition and development makes in delivering the objectives set out in Table 1 of the Property Acquisition & Development Strategy. This explanation shall reference the Strategy's core goal and objectives, in the context of NHDC's corporate objectives and plans.
- Information to enable quantitative assessment of NHDC's risk exposure resulting from acquisition or development. This is likely to include operating costs and tenant voids.
- Achievement or progress against performance targets and limits for each property or portfolio.
- The assessment by the PSG of the risk of loss to NHDC of entering into each property acquisition or development, detailed earlier.

Contingency & exit planning

The PSG will decide upon measures to address the following issues:

- Risks that arise that may prevent property that is in NHDC's possession from continuing to underpin or enable achievement of NHDC's functions or the benefit, improvement or development of its area.
- Reductions in rental income, for example, due to tenant voids and defaults.
- Delays and costs in securing rental uplifts, for example due to landlord-tenant disputes arbitration.
- Falls in Fair Values.
- Optimum exit strategy. Issues to be addressed here, include:
 - Disposal method to realise best value, or effect the quickest/least cost disposal. Examples are auction or private treaty.
 - Apportionment of lot sizes to achieve optimum disposal price.
 - Capital expenditure to improve marketability of assets, for example to reverse obsolescence or dilapidations.

Strategy review

The PSG is responsible for reviewing the Property Acquisition & Development Strategy annually and updating the Strategy every 5 years.

Frequency of PSG meetings

- *When new opportunities arise:* Property opportunities will be grouped for consideration by the PSG, where appropriate.
- *When performance monitoring & assessment of assets is conducted:* Feedback on the monitoring of assets acquired or developed will take place at least on every annual anniversary of the acquisition or development completing.

Circumstances may dictate more frequent meetings, for example when market events or economic conditions materialise that pose risk to NHDC's properties.

Professional opinion

Acquisition and development opportunities may arise that meet the core goal, objectives and asset criteria of the Property Acquisition & Development Strategy but which may be incompatible with NHDC's objectives outside the Strategy, such as ethical policies. In these circumstances, the PSG will be permitted and required to use its collective professional opinion, judgement and discretion when forming its recommendations on whether or not to pursue acquisition and development opportunities.

Advice & evidence resources

The PSG's appraisals and recommendations will be supplemented by advice from independent external advisers, by other NHDC officers, and by consultation with NHDC's Asset Management Group (AMG), should the PSG members require. Information and evidence cited by the PSG will include:

- Valuations, market appraisals, market commentary and research data.
- Building surveys.
- Lease reviews.
- Energy Performance Certificates.
- Planning advice.
- Searches, including Land Registry investigations.
- Credit agency ratings and references from banks, accountants and previous landlords for assessing rent payment and rent arrears track records, as well as tenant covenant.

External advisers and AMG members are permitted to attend meetings of the PSG and their advice can be incorporated into recommendations of the PSG.

External advisers will be rotated on a 5-yearly basis to uphold quality of advice. Advisers may be retained for longer than 5 years if PSG members agree such extended retention outweighs the potential downsides. External advisers will be required to:

- Sign a confidentiality agreement.
- Read NHDC's Property Acquisition & Development Strategy, including appendices, prior to carrying out their instructions.
- Sign a letter of engagement confirming their understanding and acceptance that they will advise NHDC in the capacity of a local authority where the prime purpose is to deliver statutory services to local taxpayers.

Detailed matters of cost and procurement in commissioning external advisers are outside the scope of these Terms of Reference and the Strategy. These matters will be addressed prior to commissioning external advisers and their attendance at the PSG meetings.