HIGHER INCOME FOR LOCAL AUTHORITIES

THE LOCAL AUTHORITIES' PROPERTY FUND

Increasing your income, diversifying your risk

The Local Authorities' Property Fund – A pooled investment fund, managed by CCLA, created by local authorities for local authorities

CCLA

PROPERTY AS AN ASSET CLASS

THE NEED FOR ALTERNATIVES TO CASH

The rationale for looking at alternative asset classes is that the outlook for cash investment remains challenging. Interest rates are expected to remain low for the foreseeable future with the risk that the real value of capital invested in cash is eroded over time by inflation. In addition, investors have to understand the implications of "bail-ins" and the threat that these pose to their capital.

One option for investors to boost choice and improve returns could be to reduce their minimum credit rating thresholds towards the lower end of the investment grades or to extend the maturity limits to invest in a portfolio of longer-term bank deposits. Unfortunately this course of action adds little to income in the current environment but would result in a significant increase in credit risk exposure.

Even in more supportive conditions cash deposits offer strictly limited returns, the best that can be hoped for is the return of the principal plus interest. Other asset classes, such as shares and property, give the investor the ability to participate in rising asset values and the potential for a growing income over time.

To ease the pressure on counterparty lists, diversify investments away from financial institutions and to boost the income from their investments, local authorities should consider property for a portion of their strategic long-term balances.

WHAT IS PROPERTY?

For investment purposes, commercial property is usually considered to consist of three broad sectors: office, retail and industrial. Owning property brings exposure to a physical asset and the rights associated with it, in addition the purchase entitles the investor to the future income streams from rent and any capital growth from that land or building.

All properties are unique; their value is determined by factors such as location, build quality and condition and also the length of the lease, the strength of covenant provided by the tenant and the size of the current and potential income stream. Conditions in the property sector and indeed in the wider investment market will also be important.

Each property therefore has different return and risk characteristics which can be combined to build portfolios to meet particular requirements. For investors concerned about volatility in capital values, a lower risk strategy might be to hold prime assets in sought-after locations with high quality tenants secured on long leases. However the income achieved by this approach will be lower. Alternatively, investors might seek higher gains and a higher income from opportunities where, for example, the quality of the asset is good but the tenant or lease can be improved. The risk/return characteristics of property strategies can differ greatly and these need to be understood by potential investors.

BENEFITS OF INVESTING IN PROPERTY

There are many benefits that may be realised from investing in property, including greater portfolio diversification and more predictable and stable income returns. Over time property has also been a useful source of capital growth.

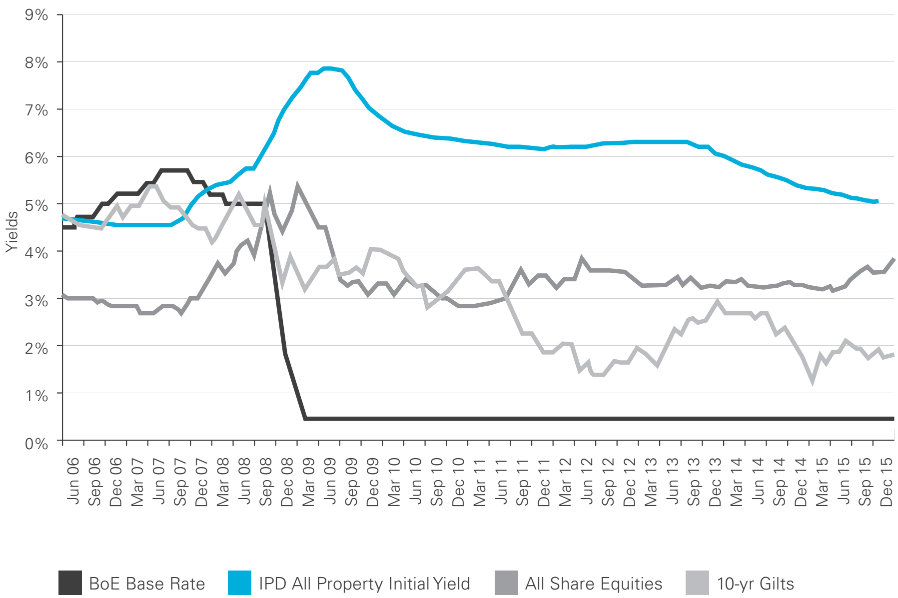
DIVERSIFICATION

Property can add value to a general portfolio because of the low correlation of its returns to those of bonds and equities. A weighting to property improves diversification and so can reduce overall risk.

HIGH AND STABLE INCOME RETURN

Over the long-term a large proportion of the total return from property has been derived from income. Income has also been the most consistent source of return. Whilst property values have risen over time, there have been down years. Income however has been far more stable and predictable, a reflection of the contractual nature of income payments in the sector. Investors who take a longer view, 5 years or more, find that their annualised total return becomes far less volatile. The table below shows the yields available on cash, government bonds and property; it highlights the relative attraction of property in the current investment environment.

Asset Class – Yield Comparison at 31 December 2015



Source: IPD/BoE/BNP - Past yield is no guarantee of similar yield patterns in future.

THE LOCAL AUTHORITIES' PROPERTY FUND

FEATURES OF THE FUND

Fund Objective

The objective for the Fund is to provide investors with a high level of income and long-term capital appreciation.

Income Distribution

Income is paid on a quarterly basis, at the end of January, April, July and October.

Minimum Investment

The minimum initial investment is £25,000.

Fees

There is an Annual Management Charge of 0.65% plus VAT.

Bid/Offer Spread

The spread reflects the cost of dealing in the underlying assets including the cost of Stamp Duty. A price spread protects investors from having the value of their holding diluted by incoming or outgoing investors. Units are purchased at an "offer" price 6.75% above the net asset value and sold at a "bid" price 1.55% below it.

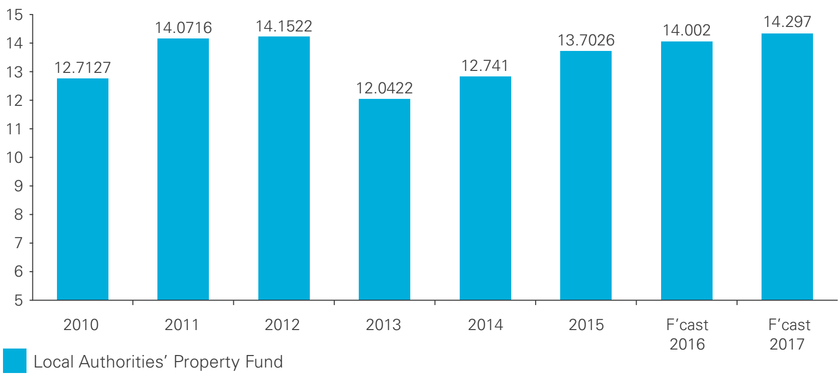
FUND PERFORMANCE

The Fund has been a consistent performer in its sector and has outperformed its benchmark,* both over the recent past and the longer term.

An important contribution to the Fund's strong record has come from the active management of the property assets. A proactive approach to tenant management, combined with the quality of the portfolio has ensured that the exposure to empty properties has remained low.

The income distribution has been relatively smooth despite the potentially disruptive effects of lease negotiations and portfolio changes. All income earned by the Fund is distributed to investors gross of tax.

Income payments on the Fund for the year to 31 December



Source: CCLA and IPD – Past performance is no guarantee of future returns

*The benchmark is the IPD Other Balanced Property Funds Index.

GOVERNANCE ARRANGEMENTS

Fund Structure

The Local Authorities' Property Fund (the Fund) is an unregulated collective investment scheme established under a Scheme approved by HM Treasury under Section 11 of the Trustee Investments Act 1961 and is subject to the provisions of a Trust Deed dated 6 April 1972 and a supplemental Trust Deed dated 13 September 1978. The Fund is an AIF and is managed as an AIFM in accordance with the FCA Rules and the AIFMD Legislation.

The Trustee

The Local Authorities' Mutual Investment Trust (LAMIT) is the Trustee of the Fund. LAMIT is a company incorporated under the Companies Act 1948 (Registered Number 700132), limited by guarantee and not having a share capital. LAMIT is controlled by representatives of the Local Government Association, the Convention of Scottish Local Authorities, the Northern Ireland Local Government Officers' Superannuation Committee and investors in the Fund.

The Trustee's responsibilities include agreeing the investment strategy, monitoring the diversification, suitability and risk profile of the Fund's investments, reviewing the performance and expenditure of the Fund and approving the payment of dividends.

The Trustee Board meets four times each year. It receives quarterly written reports from the Fund Manager. In addition, the Property Sub Committee of LAMIT meets quarterly with the property manager to review the Fund's property portfolio, transactions and policies.

The Fund Manager

CCLA Fund Managers Ltd manages the Fund's properties and provides administrative and registrar services for the Fund and company secretarial services to the Trustee. CCLA Fund Managers Ltd is registered in England as a company (Registered Number 8735639), and is authorised and regulated by the Financial Conduct Authority (Registration Number 611707). CCLA Fund Managers Ltd is a wholly owned subsidiary of CCLA Investment Management Ltd. (Registered Number 2183088), and is authorised and regulated by the Financial Conduct Authority (Registration Number 119281).

CCLA Investment Management Ltd has over 50 years of investment management experience and on a group basis currently manages assets of more than £6.0 billion* on behalf of its clients, via its segregated management service and a wide range of pooled funds. LAMIT owns 13.5% of the share capital of CCLA Investment Management Ltd, with the remainder owned by its charity and church investment funds and executive directors.

This unique ownership structure means that CCLA is in a position to understand the particular needs of the public and voluntary sectors.

*(Source: CCLA as at 31st March 2016)

Management Arrangements

CCLA Fund Managers Ltd provides LAMIT with all the investment management, property management and administration functions for the Fund. These include the valuation of the Fund's assets in conjunction with the External Property Valuer (the Valuer), the issue and redemption of units, the operation of the Fund's Register, the payment of dividends and the maintenance of the accounts of the Fund.

The valuation of the Fund's properties is undertaken by the Valuer on the monthly valuation dates. Additions to the portfolio are valued externally after acquisition. The current Valuer is BNP Paribas Real Estate.

Risk Control

CCLA has permanent operational and investment risk management functions that are hierarchically and functionally separated from the operating units and have the necessary authority and access to relevant information to perform their roles effectively.

CCLA has an operational risk management framework which provides a consistent methodology for the assessment, mitigation and reporting of operational risk, ensuring that a high quality of risk management and control is maintained throughout the organisation. CCLA has documented a risk management policy, appropriate to the nature, scale and complexity of both CCLA and the LAPF, which identifies all the relevant risks to which the Fund is or may be exposed. Quantitative and qualitative risk limits have been established for relevant risks, in line with the risk profile of the Fund. An Investment Risk committee oversees investment risk management activity.

Eligible Contributors

The units of the Fund can only be issued to and owned by local authorities in England, Wales, Scotland and Northern Ireland. The Trustee and the Fund Manager are required to satisfy themselves as to the identity of participants in the Fund for money laundering purposes.

Safe Custody of Assets

The Trustee has appointed Hogan Lovells LLP to provide safe custody services for the English properties owned by the Fund. Scottish property documents are held by DLA Piper Scotland LLP.

Reports and Accounts

The Fund operates on a financial year to 31 March and publishes its report and accounts every six months, these are subject to external audit. The Trustee is required to prepare accounts which give a true and fair view of the financial position of the Fund at the end of each half-yearly accounting period and the movement in net assets for the period.

The Manager publishes a quarterly factsheet as at the end of March, June, September and December each year. The report and accounts and factsheets are all available on the Manager's website www.ccla.co.uk.

BENEFITS AND RISKS

BENEFITS OF INVESTING IN THE FUND

1. Local authorities have been long-term investors in property through directly purchased assets, but a simpler and more efficient route is to invest in a suitable property fund.

2. Whereas a directly held portfolio requires a substantial scale to achieve an appropriate spread of investments, a unitised approach can work regardless of the scale of the investor. It allows the efficient management of the underlying property and can offer geographical and industry diversification. Furthermore, the Fund offers unique accounting advantages. These are explained on page 9.

3. The LAPF gives local authorities an exposure to a diversified portfolio of commercial property throughout the UK. For investors it eliminates the issues of maintenance, management and repairs, reduces property specific risk and improves liquidity.

4. The Manager aims to add value by active management including upgrading the asset, improving the quality of the tenant or lengthening the income stream. The size of the Fund allows it to adjust swiftly to changes in investor sentiment and market conditions in the various sectors in the industry.

RISKS OF INVESTING IN THE FUND

Risks arise in three main areas: the risk of declines in the value of the investment, the risk of illiquidity and the risk from gearing.

RISES AND FALLS IN VALUE

The value of units will rise and fall in value over time, reflecting sector and underlying property conditions. These price trends can persist over medium term periods. The Fund has an investment strategy which seeks to provide a relatively high income and to take an active approach to asset management. These policies could exacerbate market trends.

LIQUIDITY AND COSTS

Property is an illiquid asset class and it is not always possible to sell units immediately. The costs of dealing are also relatively high. These two facts suggest that the investment horizon for investors in the Fund should be measured in years.

GEARING

The Fund has a modest loan facility which is used to provide liquidity and support returns. The existence of borrowings can amplify any change in unit values.

ACCOUNTING AND REGULATORY ISSUES

ACCOUNTING FOR INVESTMENTS

The Fund benefits from a favourable accounting and regulatory framework, where dividends are treated as revenue income but the General Fund is protected from fluctuations in the unit price. Uniquely and unlike other property funds or direct property purchases, the Fund does not count as capital expenditure for English and Scottish local authorities.

Classification

Under International Accounting Standard 39 and the current CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, a local authority's holding in the Fund will be accounted for as an Available for Sale financial asset.

Purchase

The holding will be recognised on the balance sheet under Long-term Investments at the same value as the cash price paid for the units, plus direct transaction costs, if any.

Dividends

Dividends are recognised as "other investment income" within the Financing & Investment Income & Expenditure Account when the right to receive payment is established. Since the Fund rules require the payment of a dividend comprising the Fund's net income each quarter, local authorities should accrue the dividend for the quarter ending 31 March that will be paid in April each year.

Capital gains and losses

At the end of each financial year the value of the local authority's investment will be adjusted to equal the number of units held multiplied by the published bid price, with the gain or loss taken to the Available for Sale Reserve. Movements in the unit price therefore have no impact on the General Fund until the investment is sold or impaired.

An investment in the Fund would only be considered impaired if there was a significant or prolonged decline in the unit price below the level at which the units were bought. In that case, the loss would be removed from the Available for Sale Reserve and shown as an impairment loss in the Financing & Investment Income & Expenditure Account.

Sale

The full difference between the purchase price and the sale proceeds (net of any earlier impairment losses) will be shown in Financing & Investment Income & Expenditure, with the balances in the Long-term Investments and the Available for Sale Reserve reduced to zero.

Where units have been bought at different prices and only part of the holding is sold, it will be necessary to determine which units have been sold to calculate the gain or loss since purchase.

CAPITAL EXPENDITURE TREATMENT

England: The acquisition of share capital in a body corporate, including units in unregulated collective investment schemes, normally counts as capital expenditure under section 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended). However, as a scheme approved by HM Treasury under section 11(1) of the Trustee Investments Act 1961, and in accordance with section 25(3) (d) of the regulations, the purchase of units in the Fund does not count as capital expenditure in England.

Scotland: The Scottish Government has not made regulations on the acquisition of share capital, so the purchase of units in the Fund does not count as capital expenditure in Scotland.

Wales: No such exemption has been enacted by the Welsh Assembly, so in accordance with section 20(1) (d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, the purchase of units in the Fund does count as capital expenditure in Wales.

Northern Ireland: The regulations in Northern Ireland are similar to those in Wales, so in accordance with section 12(1)(d) of the Local Government (Capital Finance and Accounting) (Northern Ireland) Regulations 2011, the purchase of units in the Fund does count as capital expenditure in Northern Ireland.

IMPACT

The effect of being classed as capital expenditure in Wales and Northern Ireland is that resources (such as capital receipts or minimum revenue provision) must be put aside to fund the “expenditure”, and the proceeds from the sale of units will be capital receipts and hence be restricted in their use. Any loss incurred on the sale of units will therefore impact on capital receipts instead of the General Fund.

RISK WARNING

The value of the Fund units and the income from them can fall as well as rise and a local authority may not get back the amount originally invested. Past performance is no guarantee of future returns. The unit value will reflect fluctuations in property values. The units are intended only for long-term investment and are not suitable for money to be spent in the near future. They are realisable only on each monthly Valuation Date and a period of notice, may be imposed for the redemption of units.

The properties within the Fund are valued by an external property valuer; any such valuations are a matter of opinion rather than fact. Yields may vary and are not guaranteed and are quoted on a pre-tax basis after deduction of management charges.

CCLA Fund Managers Ltd (Registered in England No. 8735639 at Senator House, 85 Queen Victoria Street, London EC4V 4ET) is regulated by the Financial Conduct Authority and is the manager of the Local Authorities' Property Fund. The Trustee is the Local Authorities' Mutual Investment Trust (Registered in England and a company limited by guarantee No 700132 at the above office).

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www.ccla.co.uk

CCLA Investment Management Ltd (Registered in England No. 2183088) and CCLA Fund Managers Ltd (Registered in England No. 8735639) whose registered address is: Senator House, 85 Queen Victoria Street, London, EC4V 4ET. Are authorised and regulated by the Financial Conduct Authority.

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