

INVESTMENT STRATEGY

DRAFT

1. Introduction

Crown Estate Scotland (Interim Management), trading as Crown Estate Scotland, is a public corporation established by Scottish Government to manage Crown Estate assets in Scotland.

Its legislative framework includes a duty to maintain and enhance the value of the estate and the returns obtained from it, but with due regard to the requirements of good management. Its aims and objectives are designed to align closely with Scottish Ministers' economic strategy and National Performance Framework.

Crown Estate Scotland is the interim body responsible for management of the assets until new legislation establishes longer term arrangements. It is anticipated that the operational timeline for the "interim" organisation is around 3 years. This is reflected in both the [Corporate Plan](#) and this strategy.

As an interim body, Crown Estate Scotland will take a measured approach to investment, providing continuity for stakeholders and tenants whilst being able to respond to changing circumstances and opportunities and being mindful of emerging legislation.

This strategy will allow for pilots of local asset management. Until further legislation is enacted, Crown Estate Scotland will remain responsible for the management of the assets.

2. Investment Aims and Objectives

The strategy aims to develop the resilience of the income streams and improve asset performance whilst broadening the wider public benefits delivered. A prudent and active asset management approach will reduce liabilities and seek to diversify income streams.

2.1 Crown Estate Scotland's investment aims are to:

- i. Maintain and enhance the value of the estate.
- ii. Increase the resilience and diversity of income streams generated from the estate.
- iii. Improve the social capital and environmental impacts derived from our assets.

2.2 Specific objectives, aligning with strategic objectives 1, 2, and 3 in the Corporate Plan, are to:

- i. Maintain and enhance the rural, coastal and urban assets through investment in infrastructure development and fixed equipment.
- ii. Invest in the development of offshore renewable energy,¹ carbon capture and storage, and aquaculture (finfish, shellfish and seaweed).

¹ Marine Scotland is currently beginning the identification of potential areas for new offshore wind energy sites, with work (including an SEA) culminating in a Sectoral Marine Plan for Offshore Wind. Areas open to applications through Crown Estate Scotland's new offshore wind leasing process, currently being designed, will align with the areas identified through Marine Scotland's strategic planning process. See <http://www.crownestatescotland.com/maps-and-publications/download/159>

- iii. Build a capital fund of £10m over 3 years (equivalent to 3.6% of the capital value of the estate as at 31 March 2017). This is in addition to the ongoing minimum requirements for capital expenditure, approx. £4m to £5m per annum. The total capital requirement over 3 years is therefore in the range of £22 – 25m.
- iv. Identify and dispose of non-core assets (assets that are not integral to the aims and operation of Crown Estate Scotland and which may typically be lower yielding).
- v. Comply with lease obligations and manage liabilities.
- vi. Develop and keep under review criteria for appraising investment opportunities including assessing commercial returns, sustainability, economic, social and environmental benefits.
- vii. Ensure that decisions do not constrain future management of assets following new legislation.

3. Our Business

3.1 Crown Estate Scotland actively manages assets through four principal activities:

- i. *Investment management*: buying and selling assets in line with the investment strategy.
- ii. *Development management*: planning, constructing and developing property to create successful places where tenants' businesses and communities can thrive sustainably.
- iii. *Asset management*: leasing, licensing and managing the use of assets by third parties, working closely with tenants to help achieve their objectives while increasing asset value and revenue return.
- iv. *Property management*: investing in the long-term sustainable development of property, working in partnership with others to ensure the needs of Scottish Government, tenants, stakeholders and communities are recognised.

Much of what happens on the land and property Crown Estate Scotland manages is carried out by tenants. All tenants, as well Crown Estate Scotland, are required to adhere to the relevant statutory consenting procedures in developing their specific projects and how they manage land. This strategy focusses on investment decisions relating to how Crown Estate Scotland will manage the assets as a portfolio – it does not prescribe specific projects at specific locations.

4. Strategic and Operational Context

4.1 Corporate Planning

The strategy is guided by the 2017-20 Corporate Plan and influenced and informed by existing operational business plans. The [annual report](#) is the primary mechanism for reporting on progress. Further detail relating to specific priorities and opportunities included in this strategy can be found in the Corporate Plan.

4.2 The Legislative Background

The assets are part of the hereditary possessions of the Sovereign in right of the Crown. Crown Estate Scotland is responsible for managing the transferred assets under the provisions of the Scotland Act 2016, which in turn devolved provisions of The Crown Estate Act 1961.

Under these statutory provisions Crown Estate Scotland must: -

- i. Manage and turn to account land and other property, rights and interests forming the Crown Estate in Scotland;*
- ii. Maintain the estate*
 - a. as an estate in land*
 - b. and maintain and enhance its value and the return obtained from it, but with due regard to the requirements of good management;*
- iii. Sell, lease or otherwise dispose of any land of the Crown Estate, or any right or privilege over or in relation to any such land, for the best consideration in money or money's worth which in their opinion can reasonably be obtained;*

The assets and rights transferred to Scottish Ministers are set out in The Crown Estate Transfer Scheme 2017. The Scottish Crown Estate Bill was introduced to Parliament on 24 January 2018 and is expected to be followed by secondary legislation and implementation. This has informed the timescale of the 2017-20 Corporate Plan.

It is recognised that the strategy and any decisions based thereon will, of necessity, take a longer-term view. This reflects the timescales necessary for the development of projects and the duties of Crown Estate Scotland.

4.3 Capital Accounting

There is a need to separate revenue and capital in Crown Estate Scotland. Net revenues are paid to the Consolidated Fund of Scottish Government while realised capital must be retained and used to maintain and enhance the value of the estate. Under current arrangements with Scottish Government, each year an amount equal to 9% of turnover is permitted to be transferred from the revenue to the capital account.

Asset valuations are carried out annually by third party valuers. Unoccupied areas of foreshore or seabed are not generally attributed a value.

To manage the estate effectively, Crown Estate Scotland needs access to 'liquid' capital to meet required investment requirements (i.e. those that Crown Estate Scotland has a legal or regulatory obligation to make) alongside discretionary investments to maintain and enhance asset value and income returns. Maintaining a proportion of the capital asset as cash on account allows Crown Estate Scotland to respond to these business needs.

4.4 Minimum Capital Requirements

The day to day operations of Crown Estate Scotland require the expenditure of capital. This includes funding capital works (e.g. replacing fixed equipment on farms) and paying for staff whose work is capital in nature. The investment appetite of each of the sectors can be expanded or contracted as



opportunities arise. The minimum projected requirement for capital is in the region of £4m to5m per annum.

5. Raising Capital

5.1 Access to capital to maintain and enhance the estate is crucial to the long-term integrity and sustainability of the asset base. Asset liquidity is more readily achieved from the rural and urban assets. Of these, the income yield achieved from rural assets is substantially lower. Therefore, the primary source of capital to meet the development requirements and investment aspirations for the timescale of this strategy will be the rural estate. This strategy does not propose, nor require, a large-scale disinvestment or sale of rural assets. However, the ongoing sale of non-core assets, residential and other property (either through sales to tenants or open market transactions) will continue within the context of this strategy and the published [farm sales framework](#).

A capital fund will be established over 2017/18 and the subsequent 2 years to provide for investment in existing and new assets and to meet unforeseen capital requirements. The fund to be established is £10m (this is over and above the ongoing required capital expenditure).

5.2 The strategy for releasing capital from rural and coastal assets includes;

- i. Capital release from non-core rural assets, where this can be done without impact on the integrity of the estate or a significant negative impact on the provision of wider public benefits.
- ii. Sale of agricultural units in line with the farm sales framework.
- iii. Sale of land for strategic development – commercial and residential.
- iv. Sale of assets (forests, residential property, fishing rights, pontoons etc.) with a high capital investment liability and/or limited prospect of revenue growth in the medium or long term.
- v. Sale of non-core assets to community bodies to support sustainable development, where this does not compromise the integrity of the estate or impact capital value.
- vi. Sale of seabed occupied by jetties, piers, slipways, and harbour walls where there is greater value to the occupier and no long-term value to be gained from retention.
- vii. Granting of servitude rights for use of assets for infrastructure/access.
- viii. Granting of licences/leases for coastal dredging activities in return for royalty payments.
- ix. Capitalisation of long-term rental income from long leases (commercial, non-agricultural), where appropriate and where this may suit Crown Estate Scotland and the occupier.

6. Asset Management – Investment Requirements and Opportunities

Crown Estate Scotland manages a diverse set of assets. Each asset class requires ongoing expenditure to maintain and enhance value, meet various statutory obligations, and manage liabilities. The different types of assets also present opportunities for contributing to social and environmental benefits.

This strategy aims to optimise sustainable development of the assets through active management and investment, all within the context of a body with an interim status working in close alignment with Scottish Government policy.

The requirements and opportunities presented within each business sector are considered below.

6.1 Rural

6.1.1 The rural portfolio is made up of 4 estates (Fochabers, Glenlivet, Whitehill and Applegirth). These estates comprise agricultural, residential, commercial and sporting tenancies as well as forestry. They also include salmon fishings and mineral rights.

There is an ongoing programme of works to address the capital investment requirements of agricultural fixed equipment, residential property, forestry restocking and estate infrastructure (roads, buildings, roofs, residential improvements, fencing, bridges etc.)

The re-stocking and maintenance of forestry land is a requirement of good management but also presents an opportunity for capital growth and longer-term future revenue. Much of this investment is required to meet statutory/regulatory obligations, as part of an on-going asset management programme which improves property and infrastructure on the estates, allowing tenants' businesses and communities to increase their viability and develop sustainably.

Opportunities also arise for investment in the restructuring of agricultural leases through lease expiries or surrenders which unlock capital value and increase flexibility for raising capital or revenue through re-letting or sale.

The annual requirement for ongoing operational capital investment on the rural estate is approximately £2.6m, although this can vary depending on changes in regulatory requirements, the impact of weather and a range of other factors.

6.1.2 The strategy for meeting obligations for investment in the rural estate involves:

- i. Continuing to meet investment obligations for fixed equipment on agricultural holdings as part of a prioritised, phased, annual programme of works.
- ii. Forest restocking as required under the terms of felling licences and as part of a phased restocking programme. Following advice, including from Scottish Government, such investment is accounted for as capital investment.
- iii. Prioritising works required to meet regulatory requirements for electrical safety, asbestos management, water supply quality and other property infrastructure. Ensuring the fabric of

the rural estate (roads, roofs, forest fencing, bridges, culverts, flood defences etc.) is maintained and enhanced, managing health and safety obligations, mitigating against future risks and maintaining the capital value of the asset base.

As well as a source of capital to meet obligations for investment on the rural estate and elsewhere in the business, the rural assets also present opportunities for investment to generate higher financial returns, alongside delivery of broader economic, social and environmental returns.

6.1.3 The opportunities in the rural estate include investment to:

- i. Support farm diversification, agroforestry, farm business consolidation/restructuring, tourism and other non-agricultural commercial enterprises.
- ii. Facilitate voluntary lease restructures or surrenders to allow for (a) commercial or residential development planning), (b) opportunities for expansion or restructuring of existing tenants' businesses, (c) open market re-letting, (d) opportunities for new entrants, (e) sales or (f) alternative uses.
- iii. Develop and enhance local economic activity (such as tourism), and natural and cultural heritage, to promote long-term sustainable development.
- iv. Raise the overall standard of residential assets and to increase revenue returns.
- v. Promote and support partnerships which drive third-party investment, generate public benefits and future revenue and/or capital growth
- vi. Work with tenants to identify improvement works and investment.

6.2 Coastal

6.2.1 Crown Estate Scotland manages just under half of the foreshore and most of the seabed out to the 12-nautical mile limit. It grants occupation rights to foreshore and seabed for marine infrastructure, e.g. ports and harbours, marinas, bridges, cables, outfalls, pipes, moorings and dredging.

Crown Estate Scotland helps coastal communities manage their local marine resource through, for example, local authority regulating leases and mooring associations, and supports marine leisure tourism by providing expertise and funding for strategic research at a local and national level.

Crown Estate Scotland manages Rhu Marina which is principally held under lease by Quay Marinas, with other occupiers in some of the associated buildings. There is an ongoing requirement for low level capital investment in the Rhu Marina infrastructure to support the current rental income and maintain the fabric of the property. Long-term development of the Marina will require significant investment.

Opportunities for raising capital in coastal assets are limited by the low-value and temporary nature of many of the coastal activities. There is a general presumption in favour of leasing foreshore. Crown Estate Scotland is developing a protocol for community acquisition, in line with established best practice, to promote appropriate opportunities for disposals to communities.

6.2.2 Strategic priorities for raising capital from the Coastal assets include:

- i. Facilitating sale of foreshore, occupied seabed and coastal infrastructure (pontoons) to communities or port authorities in line with agreed protocols.
- ii. Facilitating or promoting dredging activities around the coastline (subject to marine licences).
- iii. Investigating opportunities for the capitalisation of rent for long term leases.

6.2.3 The strategic opportunities for investment in the coastal assets over and above normal operational expenditure include investments in;

- i. Economic impact/feasibility studies to inform future investment in coastal infrastructure which will drive future revenue streams and assist wider objectives to develop marine tourism and coastal business activity.
- ii. Infrastructure at Rhu Marina in partnership with other agencies to drive long-term economic growth opportunities.
- iii. Investment in stewardship or community initiatives which deliver significant value for local economic development, community viability and environmental benefit.

6.3 Urban

Crown Estate Scotland currently manages one Urban property - 39-41 George Street - a mixed-use commercial property in Edinburgh's prime 'golden rectangle'.

Capital will be used to fund the refurbishment of vacant space (taking into account likely dilapidation receipts from tenants), required mechanical and electrical upgrade works and planning consultancy advice.

The scope for further investment in similar properties of this scale is limited given the level of capital available in the timeframe of this strategy. However, opportunities for further investment in this sector – which could include office, industrial, retail or other commercial property – on a more modest scale, or if additional capital funds become available, are considered worthy of consideration due to the attractive returns and asset and risk diversification.

7. Development of Assets

Crown Estate Scotland manages the seabed out to 12nm and out to 200nm for renewable energy and the storage of gas. While substantial direct investment in individual offshore infrastructure or renewable energy projects is unlikely, there is an ongoing requirement and opportunity to invest internal resources to both optimise the existing portfolio of projects and to facilitate and design opportunities for further development of the seabed. As well as generating additional revenue and increasing the capital value of the estate, this will allow for wider benefits to Scotland and its communities.

7.1 Offshore Renewable Energy

7.1.1 Offshore renewable energy currently includes offshore wind, tidal and wave energy. The sector has provided relatively stable revenue over the last five years, with over 95% of the revenue provided by offshore wind. The capital valuation has generally increased as the offshore wind portfolio has progressed through development and consenting.

7.1.2 The principal transactions which have shaped the current offshore wind position and which will influence the future development of the portfolio are;

- i. Beatrice offshore wind project – projected to be completed and providing full revenue in 2019.
- ii. The addition of new Agreements for Lease for Zone 1 (Western Development Area) and Zone 2 (Phase 2 development).
- iii. The Zone 1 (Eastern Development Area), which secured a Contract for Difference in September 2017
- iv. The outer Forth and Tay offshore wind projects

7.1.3 Future development opportunities in Scotland requiring capital funded staff resources and research studies include;

- i. Further offshore wind development. This will include a new offshore wind leasing round which will align with areas identified in Marine Scotland's sectoral plan for offshore wind following their strategic planning process (including their SEA)
- ii. Tidal and wave energy to help create a strategic opportunity for community value via industrialisation and ownership of a sector.
- iii. Power storage and infrastructure. This has the potential to unlock resource in Scotland, principally around the west coast and islands.

Crown Estate Scotland's role is in driving business development. This includes a) working with economic development agencies to explore socio-economic benefits, b) investing in strategic R&D and c) ensuring seabed is available at the right time and on the right terms to help attract investment in new energy assets.

7.2 Carbon Capture and Storage

Crown Estate Scotland has statutory rights for gas storage under the 2008 Energy Act.

Carbon Capture and Storage (CCS) assets are currently valued at zero due to the expiry of Shell's option agreement for the Goldeneye store in the North Sea in 2015. However, there has been recent interest from UK and Scottish Governments as well as developers in taking forward smaller scale developments.

Crown Estate Scotland will work with governments and developers to facilitate future projects. This includes supporting project proposals through the leasing process, including the proposed Acorn Project in Aberdeenshire, to facilitate a first step in establishing CCS in the North Sea.

7.3 Aquaculture

7.3.1 Aquaculture is a relatively high yielding (revenue only) asset class. Revenue and valuation are dominated by farmed salmon, which represents over 95% of revenue. It is growth of this sector alongside rent uplifts at the 5 yearly rent reviews (32% in 2012 and 22% in 2017) that account for the position today. Capital investment requirements are negligible as Crown Estate Scotland does not invest directly in any aquaculture infrastructure.

7.3.2 Opportunities for securing business growth, and increased capital value, include:

- i. Prioritising access to development space for finfish (primarily salmon) by:
 - a. Working with stakeholders to improve shared marine co-existence and
 - b. Supporting business partners to invest more in improving the social licence of the industry to aid further expansion.
- ii. Supporting development of commercially viable shellfish projects, by working with the finfish sector (to encourage investment for economic stewardship purposes), with strategic (non-financial) input, through collaboration on an industry insurance scheme with the Scottish Shellfish Management Group.
- iii. Assisting with funding for research to investigate and confirm biomethane production potential of co-digested seaweed and finfish production waste-streams, to demonstrate feasibility and offer a more sustainable disposal route for salmon waste-streams. This could result in the provision of biogas for communities from local Anaerobic Digestion plants – a potentially strong community benefit that salmon industry may finance, especially if current disposal costs are mitigated.

8. Development of Other Assets Classes

There may be opportunities, not yet identified, to invest in other asset classes. It should be noted that substantial additional investment of this nature would require a review of capital requirements and potentially the need to realise further capital through sales. Where an investment is of a novel nature the board would seek guidance from Scottish Ministers.

9. Investment Appraisal Methodology

To deliver the four key functions (investment management, development management, asset management and property management), decisions regarding investment are constantly required.

Investment is built into capital expenditure budgets in accordance with operational requirements, this Investment Strategy and capital accessibility. These investments - to maintain and enhance capital and revenue as well as contributing towards wider economic, social, environmental and community benefits - require an appraisal methodology to ensure that decisions regarding the deployment of capital resources take account of all relevant factors.



Initial key criteria will be required to be met, to ensure that proposed investments are within Crown Estate Scotland's legal authority and will contribute to key deliverables in the Corporate Plan. Thereafter investment opportunities will be appraised on both financial and non-financial factors, with appropriate weightings, enabling assessment between competing opportunities for capital and resources.

A detailed methodology is under development. This will take into consideration outputs / findings from the Strategic Environmental Assessment conducted in 2018.

The methodology will be reviewed regularly to recognise the requirements of the Corporate Plan, changes in legislation, operational circumstances and emerging opportunities.

10. Investment Strategy Review

It is intended to review this strategy on an annual basis to ensure consistency with Government policies, legislation and business requirements.