Rushcliffe Borough Council

Governance Scrutiny Group

Thursday, 22 February 2024

Asset Management Plan

Report of the Director – Finance and Corporate Services

1. Purpose of report

1.1. This report is intended to provide the Governance Scrutiny Group with an update on the performance of the commercial property estate.

1.2. The Asset Investment Strategy was launched six years ago, the first review of the assets took place in 2021 (previous report to Governance Scrutiny Group in November 2021) and it was agreed then that a bi-annual update report would be provided to the Group. The objective of the asset review is to assess all of the Council's commercial property portfolio, how individual properties are performing (risk rating properties in terms of their performance and property market conditions), and what the expectations are for the next five to ten years in terms of income and costs.

2. Recommendation

It is RECOMMENDED that the Governance Scrutiny Group scrutinise the review of the Council's commercial property portfolio with both the review and any comments from the Group being reported to Cabinet.

3. Reasons for Recommendation

3.1. It is important that the Council takes a proactive approach to managing its assets to avoid any issues in the future. The review, and this accompanying report, provides transparency for members on the performance of the portfolio and allows the opportunity for review and challenge so options for the future can be considered in detail.

3.2. The report states there are currently no high-risk properties and, therefore, no immediate action is deemed to be required. However, the proposed ongoing monitoring and review will ensure that should action be required this will be brought to the attention of members in a timely manner as appropriate.

4. Supporting Information

4.1. The Asset Investment Strategy was launched six years ago and to ensure the Council's property portfolio is still performing well it was identified that a detailed review should be carried out. It is particularly important given the potential ongoing impact of Covid-19, and more recently cost of living pressures and increasingly stringent environmental requirements (see para 4.5 below), which have had a significant impact on commercial property, particularly for some property types/sectors of business and their ongoing viability.

4.2. The Council's Asset Investment Strategy in relation to commercial investments from the outset always paid due attention to market conditions. The focus of investments has tended to be industrial, warehouse and office based rather than retail, hospitality or leisure (as detailed below). Whilst this report highlights some risk, as there is with all asset investments, ultimately the highest risk detailed below is considered to be no more than a medium rating.

4.3. The Council's property portfolio is made up of industrial estates and multi let / single let buildings, incorporating 99 investment interests, 54 of which are industrial, 25 offices, 16 retail and four leisure. The total portfolio generates an annual return from rental income of approximately £1,900,000, of which around 40% is attributable to the more recently purchased investment properties. As reported in performance updates, occupancy levels are at 100% for Industrial Property and 97.18% for Non-Industrial, providing for an overall rate of 98.46% which is very positive given the current market conditions. The privately owned commercial property in the Borough is also performing well with occupancy levels of 94.9%.

4.4. Since the last review, the Council has completed the construction of Bingham Enterprise Centre, next to Bingham Arena. This was built with £2,350,000 of external funding (from European Regional Development Fund and Local Growth Fund). There are 12 self-contained offices within the building all of which are let to small businesses. 11 of the units were let within the first 4 months of the building being open and shows the demand for high quality office space as well as the expertise of the team in understanding the local market.

4.5. The Council has recently had new draft Energy Performance Certificate (EPC) recalculations completed for all of its properties in response to changes to the EPC calculation factor for electric usage, which means that properties heated by electric are likely to benefit from improved EPC ratings, compared with those heated by gas which will have worse. This has indicated there will be a number of changes to EPC ratings for the portfolio when new EPC's are required, the majority of which have improved, reducing risk and reducing or delaying capital expenditure requirements. There's an expectation that MEES [minimum energy efficiency standards] legislation will be further tightened for 2027 and 2030, although it hasn't yet been officially confirmed. Where we can we will look to obtain external funding for such works which may mean delays as we await the availability of such funding streams.

4.6. The property portfolio also includes car parks, mast sites and land but these have not been included as part of the review. In addition, the report does not cover community buildings or the Council's own operational estate e.g. the Arena, these are, therefore, out of scope for this review. The focus is on the commercial property portfolio which is leased to businesses.

4.7. To facilitate the review a detailed spreadsheet has been produced and completed by the Property Team with the support of colleagues in Finance. This includes details of all commercial property owned by the Council, the information includes for each property:

- Value (current and projected in 2028)
- Rent (current and projected in 2028)
- Yield
- Estimated Refurbishment / Upgrade costs (over the next 10 years)
- Lease length
- Age of asset
- Current EPC rating
- A risk rating which is based on four factors; statutory risk (e.g. not meeting EPC rating), condition risk, tenant covenant risk and economic obsolescence risk (e.g. changes in terms of the market). Scoring 1 – 10 (low to high risk).

4.8. It is important to note that the information on matters such as risk is a professional judgement based on officer's professional knowledge and expertise, as well as insights from agents. It is also based on the current market and so subject to change in response to issues such inflation and interest rates.

4.9. Councillors will be aware, from discussions at budget workshops, there is increasing pressure on the Council's capital programme over the next five years. Officers from the Property and Finance teams have reprofiled budgets to reduce costs and look for funding opportunities where possible e.g. UKSPF and Salix. The property portfolio, therefore, could be utilised in future to generate a capital receipt to support the Council's financial position, albeit with the associated loss of rental revenue (although this may prove to be a better option than the cost of borrowing). The challenge will be that the better value properties are likely to generate a higher capital receipt as their value is linked to a financial return, the corollary of this being that it will result in a greater loss in rental income, impacting on the revenue budget. Officers will do further work on this and consider opportunities for any disposal as part of the wider asset review strategic task contained within the new Corporate Strategy.

4.10. A summary table and graph have been produced from the spreadsheet (Appendix A and B); they provide an 'at a glance' view of the commercial property portfolio.

The table shown at Appendix A provides a summary of the spreadsheet and it includes more information about the specific reasons why a property may appear on the graph in a certain place. It also includes information on 'Net Estimated Return' and 'Net Rent Trends', not contained within the graph and highlights properties using a traffic light system. As this demonstrates there are no properties currently rated high (or a red) risk. The graph included at Appendix B shows the properties comparing projected Estimated Refurbishment / Upgrade costs over the next ten years with average risk score.

4.11. The salient points are as follows:

- There is only one property that has an average risk score higher than five (scale is 1 to 10) – Unit 3 Walkers Yard, Radcliffe on Trent
- The majority of properties have low maintenance costs (capital) over the next ten years (less than £50k). There are a few exceptions to this:
    - The Point - £400k
    - Manvers Business Park - £320k
    - 1 Walkers Yard - £70k
    - Cotgrave Business Hub - £70k
- Properties requiring significant refurbishment / upgrade costs have seen reductions to Net Rent values although The Point and Manvers Business Park are still considered to provide good annual returns compared with asset value, at 7.73% and 7.33% respectively. 1 & 3 Walkers Yard have, however, seen significant decreases to -1.75% and 4.06% respectively over the course of the next five years (and will be discussed further in 4.12)
- None of the purchased investment properties are identified as a risk and all are performing well, particularly the two units at Edwalton Business Park.

4.12. As can be seen, the table and graph (Appendices A and B) highlight that there are a number of properties that are considered to be more of a risk than others. As already stated, these are not considered to be high risk and the following table sets out further detail on some of those properties:

Property	Reason
Unit 3 Walkers Yard	The property is used as offices; should the current tenant choose to leave this could be a risk of a longer-term vacancy due to the antiquated nature of the accommodation and the ability to re-let. Over the next 5/6 years, it is also anticipated at least £30k will be needed to upgrade the current building to EPC Grade C by 2027, and then to EPC Grade B by 2030 reducing returns for this period to 4.06%. The property is however sited on the boundary of Walkers Yard Car Park and offers significant strategic value to the greater land holding of the Council, and for this reason should be retained.

Unit 1 Walkers Yard	The property is used as a micro-pub with a small independent tenant. The location of the building is off the main retail route in Radcliffe and if it were to become vacant, could prove difficult to re-let. Although the draft EPC calculation confirms the building already has reached EPC Grade B, the property is old and £70k has been provided in the Capital Programme in 2024/25, thereby significantly reducing the net average rent over the next 5/6 years, reducing returns for this period to -1.75%. The property is however sited on the boundary of Walkers Yard Car Park and offers significant strategic value to the greater land holding of the Council, and for this reason should be retained.
Manvers Business Park (MBP)	Due to the high projected property maintenance costs over the next 5 years (£320k), net rent will decline for a period however annual return on asset value still remains at a good level of around 7.33%. Returns will regain present values (9.32%) in the longer term (post 5 years). No significant capital costs have been spent on MBP since their construction at the end of 1990s / early 2000's and those highlighted in this report are attributable to the refurbishment of roofing, new roller shutter doors, new LED lighting and rewiring where necessary. These upgrades will contribute to required improvements needed to meet EPC legislation and are reasonable outlays for property of this age and type. MBP meets many of the Council's priorities, providing new and small companies industrial / warehouse units on pro-business flexible lease terms, which reduce business risk thereby supporting new economic growth and local employment.
The Point	The property already meets the future requirements of the EPC legislation, being rated a very good Grade B. With further upgrade works to the lighting in the common areas, this may in the future improve to EPC Grade A accommodation, a significant achievement for a building constructed in 2007. The property has not however benefitted from any upgrade or refurbishment works since construction and therefore Air Conditioning and Lifts will need to be replaced soon (5 to 10 years' time), in addition to maintenance works to the roof membrane and common areas amounting to around £400k. Of the nine suites, it has been (since purchase) a regular occurrence to have one suite vacant at any one time, and after Covid, relets have proven more difficult. However, marketing

	agents again confirm there is evidence that suggests businesses continue downsizing from larger office spaces and will be attracted to The Point as there is a dearth of quality office space South of the River Trent. In this regard, the Council are currently in the latter stages of negotiation with a new tenant for the vacant suite and should this progress as anticipated, will provide full occupancy with improvement to the general covenant strength of tenants. Current return is 9.58% however will drop in years 1 to 5 to around 7.73% during refurbishment works, which still remains a good return on asset value. This reduction in return could be improved should occupation rates improve from 89% for the building, which is feasible.
Phase 1, Colliers Business Park	The property is around 25 years old and maintenance costs will start increasing over the next 10 years. Some of the costs on the longer leased units will be rechargeable to the tenant however it is expected around £25k will be required to upgrade to LED lighting, with some risk of roofing repairs going forward estimated at £25k. Demand for commercial industrial / warehouse property remains strong and is a sector which has fared well during and after the pandemic and the property remains a good asset in the next 5 years providing a return of 8.87%, with a good chance of rental growth in 2026/27.
Candleby Lane Ind Estate	The Council own the freehold interest of 8 industrial units, which are currently let on a long term lease to one tenant, with around 55 years outstanding, who then in turn sub-let to small businesses. The Council receive 11.1% of all sub rents achieved however has very little control over the sub-tenants, the condition of the units and how the industrial estate is run. As such, there is a risk that required refurbishments and capital expenditure required to meet EPC legislation will not be met, and as such the income generated could be in doubt come 2027.
Debdale Lane Ind Estate	The Council own the freehold interest of the Debdale Lane Industrial Estates, which is currently let on a long term lease to one tenant, with around 55 years outstanding, who then in turn sub-let to small businesses. The Council receive 14.2% of all sub rents achieved however has very little control over the sub-tenants, the condition of the units and how the industrial estate is run. As such, there is a risk that required refurbishments and capital expenditure

	required to meet EPC legislation will not be met, and as such building standards and the income generated could be in doubt come 2027.
Ground and first floor Bridgford Hall	The property is a Listed Building, and is rated at C62, meeting the 2027 EPC requirements however would require upgrade works to meet EPC Grade B by 2030. The Council would apply for an EPC exemption in respect to the property as the works required would be difficult to pass in respect to Listed Building Consent and / or would be very expensive (i.e. adding double glazing / heat pumps), which would also prove very difficult to accomplish. The property is split into two, with the Ground Floor Registrars and Wedding Venue operated by Notts CC and the first and second floor Aparthotel operated by Birchover Residencies. The return on the property is a healthy 9.08% and the building forms part of the greater Listed Curtilage of Bridgford Park and would be retained for strategic reasons.

4.13. As the above table outlines, those properties identified as higher risk than others in the portfolio are not of significant concern, either the buildings are continuing to provide a good return on investment or should be retained for strategic reasons. The risk ratings associated with required refurbishment / upgrade results from the age of some of the properties, as well as the new requirements on energy performance standards.

4.14. The situation with commercial property can change relatively quickly due to tenants vacating, unexpected maintenance costs etc. Through the ongoing monitoring of the Council's assets this is not anticipated to cause significant challenges over the coming months. It is important that Councillors are kept informed of the property portfolio so any required decisions can be made in a timely fashion and this review is an integral part of that. Any potential commercial property disposals are reported through Cabinet and reflected in the Council's Medium Term Financial Strategy approved by Full Council. This report will be updated towards the end of the 2025/26 financial year and reported to Governance Scrutiny Group.

5. Risks and Uncertainties

5.1. As set out there are no specific properties that are identified as high risk and that shows that the Council's chosen strategy to asset investment is performing well. There are, however, risks with managing any commercial property and these includes: the changing market, vacant units that are challenging to relet, future requirements around energy performance of buildings, and the associated costs and unforeseen maintenance costs.

5.2. By carrying out this asset review and continuing with the regular monitoring of the performance of the properties including vacancy rates, required inspections, condition reports etc, the Council can ensure it mitigates these risks as much as is possible.

6. Implications

6.1. Financial Implications

The projected enhancement costs of the assets covered in the report, form part of the Council's current and proposed capital programme. Funding of these enhancements comes from the investment property reserve or external funding if it is available. Appropriate budget provision will be provided to ensure any future liabilities are met. Provisions are made for general repairs in the revenue budget and these are assessed on an ongoing basis. As costs rise and market conditions change these will influence levels of property rental income the Council will seek to ascertain, and yield achieved.

6.2. Legal Implications

There are no legal implications associated with this report.

6.3. Equalities Implications

There are no equalities implications associated with this report.

6.4. Section 17 of the Crime and Disorder Act 1998 Implications

There are no crime and disorder implications associated with this report.

6.5. Biodiversity Net Gain Implications

There are no Biodiversity Net Gain implications associated with this report.

7. Link to Corporate Priorities

Quality of Life	There are no direct links to this corporate priority
Efficient Services	Generating a revenue return to help fund the Council's budget
Sustainable Growth	The Council's property portfolio provides space for small businesses in the Borough to start up and grow.
The Environment	Ensuring properties have adequate energy ratings.

8. Recommendations

It is RECOMMENDED that the Governance Scrutiny Groups scrutinise the review of the Council's commercial property portfolio with both the review and any scrutiny comments being reported to Cabinet.

For more information contact:	Peter Linfield Director of Finance and Corporate Services plinfield@rushcliffe.gov.uk
Background papers available for Inspection:	
List of appendices:	Appendix A – Property Asset Table Appendix B – Cost vs Risk Graph