Cabinet

Tuesday, 14 December 2021

Review of Investment Assets

Report of the Director – Finance and Corporate Services

Cabinet Portfolio Holder for Finance and Customer Access,
Councillor G Moore

1. Purpose of report

1.1. This report is an update on the performance of the commercial property estate and provides a methodology for the ongoing performance of the Council's commercial assets to help inform any potential disposal in the future.

1.2. The Asset Investment Strategy was launched four years ago, and so it is the right time to review the performance of the now expanded property portfolio. The objective of the asset review was to assess all of the Council's commercial property portfolio, how individual properties are performing and what the expectations are for the next five to 10 years in terms of income and costs.

1.3. The report was presented to the Governance Scrutiny Group at its meeting on 25 November 2021, and the Group was fully supportive of the proposed approach within this report.

2. Recommendation

It is RECOMMENDED that Cabinet:

a) supports the methodology of assessing the Council's commercial property portfolio on an ongoing basis; and

b) agrees that a review of the commercial property portfolio be undertaken every two years reporting back to the Governance Scrutiny Group and 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 that 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 four 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 in light of Covid-19, which has had a significant impact on commercial property although the legacy implications of this are still to be determined.

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 £1,600,000, of which around 35% is attributable to the more recently purchased investment properties. As reported in performance updates, occupancy levels are at 96%, this is slightly down on previous years (99% at the same time in 2020) but 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. The property portfolio also includes car parks, mast sites and land but these have not been included as part of the review as the focus is on the commercial property portfolio which is leased to businesses. These are, therefore, out of scope for this review.

4.5. 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 2026);
- Rent (current and projected in 2026);
- Yield;
- Maintenance costs (over the next 10 years);
- Lease length;
- Age of asset;
- EPC rating; and

- 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).

4.6. It is important to note that the information on matters such as risk is subjective and based on informed estimates (officer's professional knowledge and expertise as well as insights from agents). It is also based on the current market and Covid has had an impact on commercial property. The scale of this is to be determined, as such, much of this information must be caveated to reflect that wider context and the ongoing impact of Covid, particularly in some sectors.

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

4.8. The graph included at Appendix A shows the properties comparing projected maintenance costs over the next 10 years with average risk score. To make values comparable the maintenance costs have been changed to a scale as shown below the graph.

4.9. The table shown at Appendix B 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.

4.10. The salient points are as follows:

- No property has an average risk score higher than 4.75 (scale is 1 to 10).
- A high proportion of properties have low maintenance costs over the next 10 years (less than £50k).
- Some maintenance costs are high but generally this is for commercial estates rather than individual assets, with the exception of Unit 1 Bardon; Unit 10 Moorbridge Road and The Point.
- Properties requiring significant maintenance costs have seen reductions of between 8% and 22% to Net Rent values; however, are still considered to provide good or acceptable annual returns compared with asset value, ranging from 5.3% to 9.4%.
- Unit 1, Bardon is the only one of the recently purchased investment properties that is identified as a risk (for reasons outlined below) and all of the others are performing well, particularly the two units at Edwalton Business Park and the Co-op at Trent Boulevard.

4.11. As can be seen the graph and table (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, though these are not considered to be high risk and the following table sets out some further detail on some of those properties:

Property	Reason
Manvers Business Park (MBP)	Due to the high projected property maintenance costs over the next 10 years (£495k), net rent will decline for a period however annual return on asset value still remains at a good return of around 7%. Returns will regain present values in the longer term (post 10 years). No significant capital costs have been spent on MBP since their construction and those highlighted in this report are attributable to new roofing and upgrading required to meet EPC legislation, which are understandable outlays for property of this age and type. MBP meets many of the Councils priorities, providing new and small companies flexible lease terms, which reduce business risk thereby supporting new growth and local employment.
The Point	As well as the significant maintenance costs, this property could be considered to be a greater risk as it is an office building and there may be a reduced requirement for this type of space from businesses resulting from the pandemic (noting two tenants have vacated suites in the last 12 months). However, marketing agents have confirmed there is evidence that suggests there are also businesses downsizing from larger office spaces and The Point still provides an attractive opportunity to these businesses. No significant capital costs have been spent on the property since construction and those highlighted are attributable to new roofing works; upgrading of Air Conditioning (and other plant in years six to 10), as well as refurbishment of suites to meet EPC legislation, which are understandable outlays for property of this age and type. Return on investment going forward is projected to reach around 7%, which still remains a good return on asset value. It is anticipated these rates of return will rebound to former levels once the upgrade works have been completed.
Unit 10, Moorbridge Road	Due to the projected property maintenance costs over the next 10 years (£75k), net rent will decline although return on asset value remains at a good level of around 7%. The maintenance costs are attributable to upgrading required to meet EPC legislation, which is understandable for this type and age of property. Demand for commercial industrial / warehouse property remains strong and is a sector which has fared well during the pandemic. Despite the limited current outlay, the property remains a good asset.
Phase 1, Colliers Business Park	Due to the projected property maintenance costs over the next 10 years (£65k), net rent will decline although return on asset value remains strong at around 9%. The maintenance costs are attributable to roofing and upgrading required to meet EPC legislation and are understandable outlays for property of this type and age profile. Demand for commercial industrial / warehouse property remains

	strong and is a sector which has fared well during the pandemic and the property remains a good asset.
Boundary Court, Castle Donnington	Similar to The Point, Boundary Court has been affected by the pandemic and one of the two tenants has vacated as a direct result of the company's new 'working from home' policies. The marketing agent has however confirmed Heads of Terms have been provisionally agreed with a strong covenanted national company who are attracted to the area and the good location. Should the new letting proceed to completion, at the proposed rental, the risk score will decrease considerably and our current downward assumption on achievable rental income will be reversed.
Unit 1, Bardon 22, Coalville	Due to the projected property maintenance costs over the next 10 years (£130k), net rent will decline although return on asset value remains at around 5.3%. The maintenance costs are attributable to general upgrading and improvement works required to meet EPC legislation and are understandable outlays for property of this type and age profile.
Others	Unit 1/2 and Unit 3 Walkers Yard are respectively let as a micro-pub and offices. Unit 1 will require upgrade work in years six to 10, in order to meet EPC legislation (£41k). Unit 3 will require upgrade works in years six to 10, again to meet EPC legislation (£30k). Candleby Lane, Cotgrave and Debdale Lane, Keyworth are industrial estates in which the Council holds the freehold interest of the ground, being paid 11.5% of annual rental income derived by the long leaseholders via their sub-tenancies. Income may be at risk going forward as the long leaseholders will need to meet EPC standards for 2027.

4.12. As the above table outlines those properties identified as higher risk than others in the portfolio are not of particular concern. The risk ratings are associated with required maintenance much of which is due to the age of some of the properties as well as the new requirements on energy performance standards.

4.13. The situation with commercial property can change relatively quickly due to tenants leaving, unexpected maintenance costs etc. Through the ongoing monitoring of the Council's assets though this is not anticipated to cause significant challenges over the coming months. It is important that members 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.

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 this includes; the changing market particularly since the start of the pandemic and the uncertainty that still remains around that; 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 our 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. 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.

6.2. **Legal Implications**

There are no direct legal implications associated with this report. A review of assets demonstrates good governance.

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.

7. Link to Corporate Priorities

Quality of Life	
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. Recommendation

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b) agrees that a review of the commercial property portfolio be undertaken every two years reporting back to Governance Scrutiny Group and 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 – Cost vs Risk Graph Appendix B – Property Asset Table