Agenda Item No. 10

THE APPENDIX TO THIS REPORT IS NOT FOR PUBLICATION

BY VIRTUE OF PARAGRAPH 3 OF PART 1 OF SCHEDULE 12A TO THE LOCAL GOVERNMENT ACT 1972

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE WEDNESDAY, 11TH JULY 2018

ANNUAL INVESTMENT PROPERTY REVIEW

REPORT OF JENNY POOLE, CHIEF FINANCE OFFICER

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(The report is for information)

1. PURPOSE

To advise members of current property investments, their value and their performance since the last review in July 2017.

2. RECOMMENDATION

That performance of current property investments be noted.

3. BACKGROUND

3.1. A number of years ago the Council's Medium Term Financial Strategy identified that the Council had an over reliance on cash based investments in its reserves and as a consequence suffered a major risk at times of falling interest rates. The approach of keeping primarily cash based investments meant that the value of the capital deposited tended to diminish over time due to the effects of inflation given that the interest stream generated was not reinvested but is used to support the revenue budget of the Council.

3.2. As a consequence, the strategy of the Council was amended to allow take advantage of opportunistic investments in property that met the broad principles of improving the balance of the Council investment portfolio.

3.3. An investment property is a property which is not used for providing Council services. It is a property held solely for generating income or capital appreciation in the value of the property.

3.4. In September 2011 it was considered that, due to the size of investment balances, and the continuing record low levels of interest rates, the appropriate ratio of commercial property to cash would be targeted at 65% property and 35% cash.

3.5. The most recent investment acquisition took place in 2016/17, with the purchase of the De Roche Square site in Witney. It was acquired at a price of £6.25m. No new investment properties were acquired in 2017/18.

4. INVESTMENT PROPERTY UPDATE – 1ST APRIL 2018

4.1. The total investment property portfolio at 1st April 2018 is valued at £44.8m (£43.7m 1st April 17) out of a combined cash (excluding cash held for cashflow purposes) and property portfolio of £65.1m. This equates to 69% in a spread of property assets.

4.2. Appendix A to this report summarises the return on each of the properties (rent v total cost of acquisition) in the portfolio. The mean average return on the portfolio in rental returns for 2017/18 is 7.54%.

4.3. The table at Appendix A shows that the property values are in some cases lower than the purchase price. The principal reasons for this are the acquisition costs associated with such investments and the natural diminishing length of lease term that has an impact on asset values. Typical acquisition costs are 5% to cover stamp duty, fees and survey costs.

4.4. It must be stressed that any capital gains (and losses) remain unrealised and are based on estimated valuations undertaken for the purpose of the Statement of Accounts. The Council will only realise the revised valuation should it choose to sell the asset.

4.5. As mentioned above, the principal reason for the move into commercial property was to protect the Councils income stream from the volatility of interest rates rather than capital appreciation, although appreciation remains a longer term possibility should the Council chose to change its policy or choose to dispose of an asset. The financial implications section gives a commentary on the success in respect of the income stream relative to cash.

4.6. The industrial estates at Newman Court and Swain Court have been excluded as these are not capital assets of the Council (they are held under head leases). Also excluded is Greystones Industrial Estate, and other buildings which are in part operational (depot) and garages which are viewed as de-minimis and not Investment Property for the purpose of this report.

4.7. The Council's portfolio of properties has remained unchanged since 2016/17. There have been no purchases or disposals of property in the 2917/18 financial year.

5. FINANCIAL IMPLICATIONS

5.1. This report is seeking to give the Committee additional information by detailing yield not just compared to purchase price (running yield), but also, to consider the movement in the asset value, taking into account unrealised capital gains and losses.

5.2. The return on the commercial property portfolio (excluding Marriots, Woolgate and Mill Walk which were not purchased as part of the property strategy and are ground rents only) is currently approximately 7.54%.

5.3. The uplift in running yield being achieved on the commercial property compared to cash is around 5.8%. This is the difference in the net yield in Appendix A (7.54%) and the return that the Council achieves in long dated cash in pooled funds, bonds and housing association investments (1.74%).

5.4. In financial terms, this 5.8% uplift in performance from investing in property is worth around £2.3m per annum (£40.2m purchase price of IP property x 5.8%). To date, the change in strategy has saved the Council in excess of £16.5m on a cumulative basis compared to investing in cash only, and is likely to generate over £2m annually over the next one-to-two years given the outlook for cash rates. The alternative would have been the use of general fund reserve or increasing the Council Tax to fund the revenue budget had the Council not approved this change of strategy in 2011.

5.5. Investment Property must be valued for the Accounts on an annual basis. The current valuations by property are included in Appendix A.

5.6. Some individual properties are showing a drop in value. This is in the main part because other acquisition costs (stamp duty, agents' fees, etc.) are added to the purchase price of the property to make up the total acquisition cost. When the property is revalued, the revised valuation is often lower than the acquisition cost, and shows as a fall in the value of the property.

5.7. The performance of the portfolio is dependent upon the properties remaining occupied. At the time of writing this report, units 12A, 1B and Unit 13 in the Talisman Business Centre are vacant. Any vacant periods will have an impact upon investment income to the Council.

6. STRATEGIC REVIEW OF COMMERCIAL PROPERTY INVESTMENTS

6.1 This report sets out the importance of the commercial property investment returns to the Council's revenue position. The commercial property market is by nature volatile and it is sensible periodically to review the Council's investment strategy to understand the market risks and opportunities. As we move towards exit from Europe, it is important to consider how the Council's commercial property investments could be impacted. Council, in June 2018, set aside £15,000 to fund a review the Council's investment property portfolio. The outcome of the review will be reported back to this Committee at a future meeting.

Jenny Poole
Chief Finance Officer

Date: 30h June 2018