WEST OXFORDSHIRE DISTRICT COUNCIL	**WEST OXFORDSHIRE DISTRICT COUNCIL**
Name and date of Committee	**FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE**
Report Number	**Agenda Item 10**
Subject	**INVESTMENT PROPERTY OUTTURN 20/21**
Wards affected	ALL
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Summary/Purpose	To inform Committee of the performance of the Council's investment property portfolio
Annexes	Annex A – Outturn report 2020/2021
Recommendation/s	*a) To note the report*
Corporate priorities	Modern Council Services and Sustainable Finance: Delivering excellent modern services whilst ensuring the financial sustainability of the Council
Key Decision	No
Exempt	Annex A Exempt only
Consultees/ Consultation	

1. BACKGROUND

1.1. As a consequence of a strategic decision taken a number of years ago the Council holds a portfolio of property assets to help support the revenue budget via investment income. This decision was made as the Council had identified an over reliance on cash based investments in its reserves and, as a consequence, suffered a major risk at times of falling interest rates.

1.2. In addition it was identified that the approach of maintaining cash based investments risked the value of the capital deposited being diminished over time due to the effects of inflation.

1.3. As a consequence, a strategy was adopted and annually reviewed to allow the Council to take advantage of strategic and opportunistic investments in property that met the broad principles of improving the balance of the investment portfolio.

1.4. In 2019 a review of the Council's investment properties was carried out by Carter Jonas which was reported to this committee in 2020 along with the recommendations, which officers have now implemented. The advice at the time was to hold all properties and implement the asset management recommendations in respect of rent reviews and lease renewals.

1.5. Due to the changes in markets as a result of the pandemic officers within the Estates team, being Registered Valuers and Members of the Royal Institute of Chartered Surveyors, are starting a fresh review of the Council's investment property portfolio.

This report seeks to update the Committee on performance of the portfolio.

2. MAIN POINTS

General Property Update

2.1. In September 2011 the Committee took a strategic view that the investment strategy, with continuing record low levels of interest rates, should adopt a target ratio of commercial property to finance assets of 65% property and 35% cash.

2.2. The total investment property portfolio (including strategic sites Woolgate etc) now stands at £51.6m out of a combined cash (excluding cash flow) and property portfolio of £77.3 , around 67% therefore, in a spread of property assets.

2.3. In addition to setting out the running yield on the properties (rent v total cost of acquisition), the report also tries to give a view on the overall return on property by taking account of any appreciation or diminution in asset values. This also has the effect of accounting for losses incurred as acquisition costs are deleted from valuations.

2.4. The table at Annex 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 for investment purposes. Typical acquisition costs are 5% to cover stamp duty, fees and survey costs. On the portfolio overall this has now been offset by capital appreciation.

2.5. It must be stressed that these gains (and losses) remain unrealised and are based on RICS Red Book valuations calculated to comply with CIPFA requirements for asset valuation. Annex A identifies the overall return on property assets taking account of the issues set out in 2.4 above.

2.6. As mentioned above, the principal reason for the move into commercial property was to protect the Council's income stream from the volatility of interest rates rather than capital appreciation, although appreciation remains a longer term possibility. The financial implications section gives a commentary on the success in respect of the income stream relative to cash

2.7. The investment properties are subject to differing lengths of lease terms and these are set out in Annex A. 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, which is due to be reviewed and other buildings which are in part leased by Ubico for operational purposes, and garages which are viewed as deminimus.

2.8. Given the high proportion of long term ground rents within the portfolio (Carterton, Woolgate, Marriotts and Mill Walk) the average unexpired lease term is longer when compared to many portfolios, at around 14 years, and this provides further assurance to the Council of a relatively stable long term return. Of course this can mask a range of leases expiring in a short time period and the table below shows the rental income attributable to leases by reference to expiry dates and consequent risk to revenue streams.

Lease Expiry @ 31/03/2021	Rental Income @ 31/03/2021
Within a year /vacant	£491,102
1 year – 2 years	£140,115
2 year – 5 years	£961,710
5 years – 10 years	£199,198
10+ years	£718,222

2.9. A major focus over the coming year is to continue to make progress on leases within the 1 year, 1-2 year categories and 2-5 year category. Given the potential risk of voids in this scenario the council has made provision within its reserves for such risk. Attached at Annex A is the outturn report including all of the council's investment properties

2.10 To support the Council's commercial tenants during the Covid 19 pandemic the Council agreed deferral schemes, on qualifying criteria, in March 2020 and December 2020 to cover the national lockdowns. On 16th June 2021 Cabinet approved a set of tools to be used in respect of those tenants who have been unable to trade. These were further rent deferrals, lease re-gear and finally in exceptional circumstances a rent free period. These tools can be used by the Cabinet Member for Finance on a case by case basis. Officers are currently in discussion with two tenants that wish to make an application for further assistance.

3. FINANCIAL IMPLICATIONS

3.1. 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 overall return on property by taking into account unrealised capital gains and losses (overall yield).

3.2. The net running yield on the commercial property portfolio (excluding Marriotts, Woolgate and Mill Walk which were not purchased as part of the property strategy and are ground rents only) is currently around 6.57%. (7.5% on original cost).

3.3. The uplift in net running yield being achieved on the commercial property compared to cash is around 3.47% being the difference in the net running yield (6.57%) and the return in long dated cash in pooled funds and housing associations (3.1%). UK 10 year gilts currently attract a return of 0.73%.

3.4. In financial terms this 3.47% uplift in performance from property is worth around £1.55m per annum (£44.8m @ 3.47%). To date the change in strategy has saved the Council in excess of £19m on a cumulative basis compared to cash and is likely to save £1.5m -£2m annually over the next one to two years given the outlook for cash rates.

3.5. Some individual properties remain underperforming on an overall return basis - this is in the main part because the acquisition costs have been amortised (written down) over a shorter period of time than the older properties.

3.6. The overall return on property can be summarised as:-

(A)Overall Acquisition Price (incl costs)	£40.2m
(B)Latest Valuation	£44.8m
(C)Unrealised valuation gain (B-A)	£ 4.6m
(D)Overall Rental Stream (multi-year)	£ 30.8
(E) Total Return (D+C)	£ 35.4m
(F) Rental Yield (D/A)	76.6%
(G)Unrealised Capital Gain (C/A)	11.4%

(H)Overall Yield (E/A)	88.0%

3.8. The above analysis shows that despite acquisition costs the portfolio has now achieved an unrealised valuation gain and this together with the rental performance of the portfolio has led to, in overall terms, an extremely positive performance.

3.9. In October 2020 Cabinet approved an Investment Strategy for the Recover of West Oxfordshire which sets out a framework within which the council can consider future investment opportunities that deliver on the agreed corporate priorities.

4. RISK ASSESSMENT

4.1. Holding any asset has an element of risk associated with that holding. Whilst property has the security of 'bricks and mortar' compared to financial assets it does come with risks if that asset is not occupied or if the occupation market suffers due to difficult market conditions.

4.2. The purpose of the annual report is to enable a regular review of the asset holding to enable a view to be taken on the current risks associated with the holding.

4.3. The Council has mitigated the risk of its property holding by having a broad portfolio of assets covering a range of sectors including Industrial, Office, Retail and Leisure. It also has a mix of ground rents and full occupational leases which underpin the returns by providing longer term stability.