



WEST OXFORDSHIRE
DISTRICT COUNCIL

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Name and date of Committee	Finance and Management Overview and Scrutiny Committee Wednesday 29 June 2022
Report Number	
Subject	INVESTMENT PROPERTY REVIEW AND OUTTURN 21/22
Wards affected	ALL
Accountable member	Cllr Levy Cabinet Member for Resources Email: dan.levy@westoxon.gov.uk
Accountable officer	Andrew Turner, Business Manager for Assets and Council Priorities Email: andrew.turner@publicagroup.uk Elizabeth Griffiths, Chief Finance Officer Tel: 01993 861188 Email Elizabeth.griffiths@westoxon.gov.uk
Summary/Purpose	To inform Committee of the performance of the Council's investment property portfolio
Annexes	Exempt Annex A – Outturn report 2021/2022
Recommendation/s	That the report be noted
Corporate priorities	Provide efficient and value for money services, whilst delivering quality front line services
Key Decision	No
Exempt	Exempt Annex A only
Consultees/ Consultation	

I. 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. 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 (excluding strategic sites Woolgate etc) now stands at £45.8m (£44.8m 1 April 21). The long term cash portfolio at 31/3/22 stood at £25.6m (excluding short term cashflow funds of £13.8m) and therefore the ratio of long term property assets to overall long term assets stood at 64.1%. The details are shown below:-

Asset Class	Amount (£m)
Property	45.8
Pooled Funds	12.0
Bonds	2.5
REIT (Housing)	1.0
Third Party Loans (Housing and Solar)	10.1
Total	71.4

- 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 Councils 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 Industrial Estate which is currently being reviewed and other buildings which are in part leased by Ubico for operational purposes, and garages which are viewed as de-minimus.
- 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 20 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 @ 31/03/2022	Rental Income @ 31/03/2022
Within a year /vacant	£471,326
1 year – 2 years	£641,270
2 year – 5 years	£1,664,642
5 years – 10 years	£492,603
10+ years	£652,834

- 2.9. A major focus over the coming year is to continue to make progress on leases in the within 1 year category 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 being further rent deferrals, lease re-gear and finally in exception circumstances a rent free period. These tools can be used by the Cabinet member for Finance on a case by case basis.
- 2.11 In early 2022 the Government enacted the Commercial Rent (Coronavirus) Act 2022. This act ringfences the rent arrears for the lockdown periods and establishes a code of practice for landlords and tenants to follow in agreeing any further assistance. Officers are currently in discussion with two tenants that wish to make an application for further assistance under this act and the Council's set of tools referred to in 2.10

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 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 6.78%. (7.5% on original cost).
- 3.3. The uplift in running yield being achieved on the commercial property compared to cash is around 3.72% being the difference in the running yield (6.78%) and the return in long dated cash in pooled funds, housing associations and third parties (3.06%). UK 10 year gilts currently attract a return of 2.6% and are a useful benchmark when comparing to long term cash.
- 3.4. In financial terms this 3.72% uplift in performance from property is worth around £1.7m per annum (£45.8m @ 3.72%). To date the change in strategy has saved the Council in the order of £18m on a cumulative basis compared to cash.
- 3.5. Calculation of the overall return is quite a complex exercise which is summarised at Annex A. From this summary it can be noted that the annual overall return on property since acquisition taking account of losses due to transaction (acquisition) fees and notional unrealised valuation losses and gains is around 9.13% - some 2.35% over the running yield.

3.6. 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.

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

(A)Overall Acquisition Price (incl costs)	£40.2m
(B)Latest Valuation	£45.8m
(C)Unrealised valuation gain (B-A)	£ 5.6m
(D)Overall Rental Stream (multi-year)	£ 35.5m
(E) Total Return (D+C)	£ 41.1m
(F) Rental Yield (D/A)	88.3%
(G)Unrealised Capital Gain (C/A)	13.9%
(H)Overall Yield (E/A)	98%
(I)Annualised Time Weighted Yield*	11.18%

* This takes account of both the relative size of the property and the length of time held in addition to the yield on the property.

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 response to continued funding pressures facing the Council a Recovery and Investment Strategy was approved in October 2020 which sets out parameters for future acquisitions that deliver both council priorities and offer investment return to cover cost of capital and risk.

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.