NOT FOR PUBLICATION
This report contains exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972 (matters affecting the financial affairs of the Council) - (applies to Appendix 2 and 3)

Report to:	**Audit Committee**
Date:	**7th December 2021**
Title:	**Investment Property – Update and monitoring report**
Portfolio Area:	**Resources – Cllr Edmonds**
Wards Affected:	**All Wards**
Relevant Scrutiny Committee: N/A	

Urgent Decision:	**N**	Approval and clearance obtained:	**Y**
Date next steps can be taken:			**N/A**
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Recommendations: That the Audit Committee:

1. Notes the performance and risks of the investment property portfolio to date.

1. **Executive summary**

1.1. This report considers the performance of the investment portfolio to date and the risks associated therewith looking forward.

1.2. Four purchases have been made to date totalling £21.5m including costs representing 43% of the agreed borrowing limit for all Council services (£50m).

1.3. The net revenue income (an ancillary benefit) after allowing for management, maintenance and risk mitigation is £300,000 per year.

1.4. The portfolio has achieved a geographic and sector balance in line with the Investment Strategy. It has not achieved a balance of spread between tenants and there are future pressure points in 2028 created by lease events.

1.5. The revised Investment strategy, in particular the location constraints and agreed borrowing limits will make balancing the portfolio difficult, particularly if funds are only able to be for in-area development.

1.6. Over the last 12 months a small number of opportunities have been considered, with none currently under active consideration, no purchases have been made since September 2019.

1.7. The PWLB (Public Works Loans Board) future lending terms consultation review in November 2020 has changed the terms on which PWLB funds can be used. Although the document references a reduction in the borrowing rate, more importantly it significantly constrains the use of PWLB funds in this area. This has meant that there is a much reduced number of opportunities that can be considered, being in-area only and not primarily for yield.

1.8. The Investment Property portfolio already considered revenue as an ancillary benefit, not primarily for yield.

1.9. The report sets out the latest portfolio valuation information as shown in Appendix 3.

1.10. The impact on the COVID crisis on the portfolio and its tenants is also reviewed in Appendix 2.

2. **Background**

2.1. Four investment property acquisitions have now been made, totalling £21.5m including associated costs.

2.2. The Investment properties are generating a net revenue income of £300,000 in 2021/22, which is an ancillary benefit which contributes to the financial sustainability of the Council, enabling it to continue to deliver, and where possible improve, frontline services.

2.3. The Investment Strategy (as adopted) was last revised in July 19. The Regeneration and Investment Strategy is on the Hub Committee Forward Plan for March 2022.

2.4. The Council has an upper borrowing limit of £50m (for all Council services).

2.5. At 30 September 2021, the Council's current level of borrowing is £28.64 million.

2.6. This report sets out the risks, statistics and performance of the investment property portfolio to date.

3. **Outcomes/outputs**

3.1. The average net income of the portfolio is 1.3% which is above the minimum target of 1% set out in the Investment strategy.

3.2. A net revenue income of £300,000 per annum is currently generated as an ancillary benefit of the investment property portfolio. This is after deducting an allowance of 10% for the management, maintenance and risk mitigation fund (a fund set up to deal with maintenance, repairs or unforeseen risks).

3.3. The Investment Property portfolio has a property in each of the main asset classes – Office, Industrial and Retail.

3.4. A geographical spread within the South West Peninsula has been achieved; Regional - Bristol, Sub-regional – Exeter & Plymouth, Local – Okehampton. Following the November 20 PWLB review the portfolio has been restricted to in-area purchases only.

3.5. Single and Multi-let opportunities have been acquired, with a mix of tenants (11 in total), including those with the strongest covenant strength.

3.6. A spread of lease expiries and breaks have been achieved, however, there are certain points, particularly 2028, at which there is a concentration of lease events. Any future purchases need to avoid having similar lease event dates. The acquired properties have various unexpired lease terms – these are shown in Appendix A.

3.7. The Revenue Earmarked Reserve for the Management, Maintenance and Risk Mitigation (MMRM) currently stands at £301,565 at 31.3.2021. This is shown in the Earmarked Reserve Note to the Statement of Accounts for 2020-21. 10% of rent from the investment property portfolio (£119,000 per annum) goes into the Revenue Earmarked Reserve for MMRM which will fund void periods, management costs and repairs as and when they arise. As at 31.3.2022, the MMRM Earmarked Reserve has a predicted balance of £417,000.

3.8. Opportunities for further acquisitions within West Devon (although limited) could further balance the investment property portfolio and the management of risk, by increasing the number of rental streams, spreading the points at which the income into the portfolio ceases (e.g. lease ends and break clauses) and increasing the diversity of tenants.

3.9. The Portfolio was revalued at March 2021 as part of the annual valuation for the Statement of Accounts, details are shown in Appendix 3 (Exempt).

3.10. Full details of the investment property portfolio performance can be found in Appendix 1. Details relating to the rental income are in Appendix 2 (Exempt).

3.11. The future of the Office is a much discussed topic, with the expectation that some people will continue to work in a 'hybrid' home/office pattern moving forward following the pandemic. It is expected that organisations may reduce their desk space. Space for meetings, collaborating, training, mentoring etc. takes on additional importance and space may be repurposed for this. The full effect of this is currently unknown as organisations are still planning for the future. However it should be recognised that this has a potential knock-on effect on the requirement for office space as organisations assess their space needs.

4 Options available and consideration of risk

4.1 With the opportunities for future purchases being limited, this would leave the investment property portfolio with the risks as highlighted above.

4.1.1 As an example, if one of our tenants did not renew their lease and another served a break clause, 73% of the current rental income could end in 2028. Alternative tenants would be sought, however, this remains a risk.

4.1.2 As a further example, 55% of the rental income of the investment property portfolio is currently paid by one tenant.

4.1.3 Therefore the net income into the Council's budget from the investment property portfolio could be significantly affected should it suffer a tenant default or tenancies ending coinciding with each other. The gross rental income from the investment property portfolio is just under £1.2million.

4.1.4 The investment property portfolio has a management, maintenance and risk mitigation (MMRM) Earmarked Reserve fund to help off-set the above situations. However depending on the income shortfall encountered, this may just cover the cost of the debt repayments rather than the whole gross budgeted rental income . Also note the issue detailed in Appendix 2 that may require funds from the MMRM reserve.

4.2 If further acquisitions are made within West Devon (recognising that opportunities are limited), the following could be considered. These are examples rather than requirements/targets as opportunities will be limited by those properties that are available to acquire.

4.2.1 Avoid properties with significant lease events in 2028 and balance the investment property portfolio with expiry dates before and after.

4.2.2 The Bristol office is quite a high proportion of the overall investment property portfolio income, particularly being single let. Look to acquire further offices, but to alternative tenants and consider multi-let offices. There are limited options for further office purchases due to the revised geographical constraints and consider the potential changing work patterns in 3.11.

4.2.3 Further balance the portfolio with further industrial/logistic property – however, noting that this sector is particularly difficult to buy at the moment, particularly within our yield and geographic requirements.

4.2.4 Continue to very cautiously consider retail, in particular supermarket and smaller convenience store opportunities, but recognise the structural changes in the retail market.

4.2.5 Continue to explore alternative sectors.

5 Proposed Way Forward

5.1 It is recognised that the Council has other demands on the level of funds it can prudently borrow. Therefore further funds for the investment property portfolio will be balanced against the requirements of other projects.

5.2 If in area development projects are further considered (such as employment assets), the Council should consider this impact on the portfolio balance and remain true to the risk based approach set out in the Investment property strategy, so as not to over expose the Council to one sector or area.

5.3 That the MMRM Earmarked Reserve fund continues to be set aside for its intended purpose (with 10% of all rental income from the investment property portfolio being put into this reserve on an annual basis, which equates to); to ensure there is a buffer against any significant unforeseen events and to deal with future likely points of expected expenditure.

6 Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	The public interest test has been applied as to whether Appendix 2 & 3 should be published and the public interest lies in non-disclosure at this time.
Financial	Y	As at the end of March 2021, 98% of the Council's investment portfolio income has been received. Therefore of the £1,190,919 of gross rental income from investment properties, only £22,914 is outstanding in arrears. Since April 2018, four investment properties have been purchased to date. The net revenue income from these investment properties (an ancillary benefit) is £300,000 in 2021/22. Further details are shown in Appendix 1. The Revenue Earmarked Reserve for the Management, Maintenance and Risk Mitigation (MMRM) currently stands at £301,565 at 31.3.2021. This is shown in the Earmarked Reserve Note to the Statement of Accounts for 2020-21. 10% of rent from the investment property portfolio (£119,000 per annum) goes into the Revenue Earmarked Reserve for MMRM which will fund void periods, management costs and repairs as and when they arise. As at 31.3.2022, the MMRM Earmarked Reserve has a predicted balance of £417,000.

Risk	Y	Refer to section 4 and Appendix 1
Consultation and Engagement Strategy		External consultation and engagement has not been undertaken with regard to this report.
Comprehensive Impact Assessment Implications		
Equality and Diversity		N/A
Safeguarding		N/A
Community Safety, Crime and Disorder		N/A
Health, Safety and Wellbeing		N/A
Other implications		

<u>Supporting Information</u>

Appendices:
Appendix 1 – Investment property performance reports
EXEMPT Appendix 2 –Rent position
EXEMPT Appendix 3 – Valuation information

Background Papers:

None

<u>Approval and clearance of report</u>

Process checklist	**Completed**
Portfolio Holder briefed	**Yes**
SLT Rep briefed	**Yes**
Relevant Director sign off	**Yes**
Data protection issues considered	**Yes**
If exempt information, public (part 1) report also drafted.	**Yes**