



# Committee report

Committee	<b>AUDIT AND GOVERNANCE COMMITTEE</b>
Date	<b>31 JULY 2023</b>
Title	<b>PROPERTY INVESTMENT PORTFOLIO ANNUAL REPORT</b>
Report of	<b>CABINET MEMBER FOR FINANCE, CLIMATE CHANGE AND BIOSPHERE</b>

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## EXECUTIVE SUMMARY

1. This report provides members of the Audit and Governance Committee with an update as at 31 March 2023 on the four mainland property investments that were purchased in 2018 using the now dormant commercial property acquisition fund.
2. The gross rental value is £1,870,941, but there is currently one vacant unit so the rent roll is £1,830,981 per annum.
3. The total income actually received between 1 April 2022 to 31 March 2023 was £1.78m (rounded up), whilst the Council incurred debt costs of £738k during this same period.
4. The cumulative net income (excluding debt costs) for the period 1 April 2022 to 31 March 2023 represented a net return of 4.91%.
5. The Council has a number of lease events taking place in 2023/24 which, when concluded, should increase the rent roll.
6. In addition, if current negotiations with one of our tenants prove to be successful, this should help increase the value of the portfolio.
7. The fund decreased in value between March 2022 and March 2023 by 15.96%.
8. The current market value of the portfolio, as determined by independent valuers, is £34.75m. This is £0.42m less than it was acquired for.

## RECOMMENDATION

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| <ol style="list-style-type: none"><li>9. To note the current position of property investment portfolio, including the total income that has been accrued by the Council.</li></ol> |
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## BACKGROUND

10. The Council's medium-term financial strategy, which is designed to help improve the Council's financial sustainability, made provision for up to £100 million to be available for a commercial property acquisition fund, subject to the approval of a commercial property acquisition strategy. Full Council at its meeting on 20 September 2017 gave its approval to such a strategy. The report recommending the strategy also proposed that reports should be prepared for submission to the Audit and Governance Committee setting out the progress of the property investment fund, including the total income that has, or will, be accrued by the Council on an annual basis.
11. The strategy was used as the framework for all acquisitions and included strict criteria to determine which properties to acquire. Those criteria included the following:
  - a balanced commercial property portfolio that provided long term rental returns and growth;
  - a portfolio of property assets with a view to diversification on individual assets by sector (industrial, offices and retail), location and risk;
  - core assets being the best property for the sector in an ideal location with long term income to high quality tenants;
  - all investments must initially provide income (yield) equal to, or above, the Council's required rate of return (IRR);
  - priority to be given to properties that yield optimal rental growth and a stable income;
  - protect capital invested in acquired properties; and
  - location to be dictated by opportunity to acquire investments that meet the strategy, with proximity to the Isle of Wight being a deciding factor when all other attributes are equal.
12. In 2018, the fund acquired four separate property investments comprising thirteen lettable units with nine tenants.
13. Portsmouth City Council (PCC), as commissioned by Isle of Wight Council, managed the fund until 1 April 2021, following which responsibility for management of the properties was then transferred to the Council's Property Services department.
14. The Council's investment strategy is in a management phase and it is not looking to acquire additional properties on the mainland.

## PROGRESS TO DATE

### 15. **Acquisition costs**

- 15.1 Including all the costs associated with purchase (Stamp Duty Land Tax, land registry fees, surveyor's fees, legal expenses, due diligence and agreed costs to PCC), the Council spent £35.17 million on investment acquisitions.

- 15.2 The four investments comprise:
- Olympic Court, Salford, Greater Manchester – acquired March 2018 for £10.8m;
  - Network Oxford, Littlemore, Oxford – acquired October 2018 for £10m;
  - Access 4:20, Aylesford, Kent – acquired April 2018 for £8.6m; and
  - Nursling Industrial Estate, Southampton – acquired November 2018 for £3.5m.

15.3 Appendix 1 is a schedule of all assets currently held within the fund.

## 16. **Rental income**

16.1 No tenants are currently in rental arrears and one unit (Unit 1, Access 4:20, Aylesford) is currently vacant and on the market.

16.2 The total rent passing is £1,830,981 per annum.

16.3 The tenants currently in occupation are:

- **Olympic Court**
  - Mettler-Toledo Safeline Ltd
  - In The Style Fashion Ltd (Tenant has vacated the unit but not yet assigned or sublet)
- **Network Oxford**
  - Nedschroef Fasteners Ltd
  - Scoto Ltd (Stagecoach Group)
- **Access 4:20**
  - Betterstore Self Storage Properties III Ltd
  - MJ Supply Ltd
  - Go Installations Ltd
- **Nursling Industrial Estate**
  - Metabo UK Ltd

## 17. **Strategy**

17.1 With a stop on acquisition activity, the immediate focus for the portfolio is continued cash-flow security and debt management. A careful and considered management approach is central to all ongoing and future lease events (mainly rent reviews and lease renewals) to avoid protracted and costly court procedures and potential void risks.

17.2 Continuing to hold and actively manage these assets in the short to medium term whilst the wider implications associated with the economy are monitored is of utmost importance. In doing so, this should protect the Council's revenue position and allow maximum opportunity for the revision of the investment strategy as appropriate.

## 18. **Investment market**

18.1 The industrial and logistics investment market took quite a turn in the second half of 2022, going from record-breaking highs to quite dramatic lows, as the

country faced the economic challenge of rising interest rates, inflation, the chaos of the mini-budget and a slowdown in the growth of online retail.

- 18.2 As 2022 was drawing to a close, it became clear that the 'race for space' seen during the pandemic had finally run its course, with take-up in the final quarter of 2022 sliding back into line with pre-2020 levels.
- 18.3 Rental growth, nationally, is now starting to ease down after two years of unprecedented expansion, partly due to the inability of occupiers to pay ever more for space without being forced to relocate or drive efficiencies elsewhere in the supply chain.
- 18.4 Nevertheless, ongoing positive fundamentals in the occupier market should restore industrial as the UK's lead performing sector over the medium term. And, while industrial's colossal outperformance of previous years will not be repeated, better rental growth prospects will be key to driving enhanced returns relative to other sectors.

## 19. **Resources**

The fund is being managed within IWC's existing resources.

## CORPORATE PRIORITIES AND STRATEGIC CONTEXT

### 20. **Keep the Isle of Wight Council solvent and take all the measures we can to improve the financial position of the council**

- 20.1 The financial performance of the mainland portfolio helps to ensure the Council can meet its stated aspiration to keep the Isle of Wight Council solvent and take all the measures we can to improve the financial position of the Council.
- 20.2 Refresh the Council's commercial strategy and approach towards securing investment and income generation opportunities. Refresh the council's procurement strategy to enhance our approach to social value, environmental sustainability and 'Think Local'.

### 21. **Responding to climate change and enhancing the biosphere**

The Council will consider all opportunities to improve the efficiency of these buildings as and when they become available to let and the opportunity arises.

### 22. **Economic Recovery and Reducing Poverty**

The Council will try to provide as much support as it can to any tenants who have experienced financial difficulties arising from the pandemic.

### 23. **Impact on Young People and Future Generations**

The report is not expected to have an applicable effect on young people or future generations.

## CORPORATE AIMS

### 24. **We will aim to spend and invest as much Council money on the Island as is possible**

The mainland portfolio currently provides a significant income stream and opportunities for capital appreciation that cannot be quickly replicated on the Island. The performance of the mainland investments is compared with Island-based opportunities to ensure maintaining investments away from the Island is not at the expense of the island.

## CONSULTATION

25. No consultation has taken place as the report is intended to provide Members of the Audit and Governance Committee with an overall summary of progress in the delivery of the Council's commercial property acquisition strategy up to 31 March 2023.

## FINANCIAL / BUDGET IMPLICATIONS

### 26. **Capital growth**

26.1 The primary objective for the Council is to protect its capital base where possible, maximise income and create a long-term, sustainable income stream. As the fund matures over the coming years and rental income grows, the impact of initial acquisition costs on overall performance should decrease.

26.2 The fund is valued annually on 31<sup>st</sup> March by an external firm of professional property valuers. Capital values are now measurable for the whole portfolio year-on-year from 1 April 2022 to 31 March 2023.

### **External Valuations 2018 - 2023**

	<b>March 2018 Value (£m)</b>	<b>March 2019 Value (£m)</b>	<b>March 2020 Value (£m)</b>	<b>March 2021 Value (£m)</b>	<b>March 2022 Value (£m)</b>	<b>March 2023 Value (£m)</b>	<b>Percentage +/- between 2022 and 2023</b>
Olympic Court	£10.8	£10.97	£10.97	£11.75	£13.675	£12.3	-10.05%
Network Oxford	Not yet acquired	£10.0	£10.0	£10.2	£12.175	£9.5	-21.97%
Access 4:20	£8.625	£8.625	£8.625	£9.1	£10.7	£9.0	-15.89%
Nursling, Southampton	Not yet acquired	£3.5	£3.5	£4.0	£4.8	£3.95	-17.71%
<b>TOTAL</b>	<b>£19.425</b>	<b>£33.095</b>	<b>£33.095</b>	<b>£35.05</b>	<b>£41.35</b>	<b>£34.75</b>	<b>-15.96% (average)</b>

26.3 The current fund value of £34.75m represents an increase of 5.62% over the initial purchase price of £32.9m (not including acquisition costs).

26.4 The purchase price, including acquisition costs of £2.2m, was £35.17m.

26.5 If the portfolio were to be sold for the estimated market price (£34.75m), this would represent a loss since acquisition of £0.42m less costs of sale (legal and agency fees).

## 27. **Rental Income (Gross Return)**

27.1 The total income received for the period 1 April 2022 to 31 March 2023 was £1.78m (rounded up).

27.2 Based on the acquisition price, the gross return up to 31 March 2022 was 4.66% and up to 31 March 2023 it was 5.06%.

## 28. **Rental Income (Net Return)**

28.1 The cumulative net income (excluding debt costs) to the council for the year to 31 March 2023 amounts to £7.34m, which represents income of £7.78m less costs of £0.44m. For the period between 1 April 2022 and 31 March 2023, this represents a net return of 4.91%.

28.2 The Council incurred costs of £52k, which includes the services provided by managing agents of £10k. The Council incurred debt costs of £738k for the financial year ending 31 March 2023.

28.3 The reserve balance as at 31 March 2023 is £1.25m. This reserve will be used to fund potential future lost rental income and future property related costs.

28.4 The net yield (including debt costs) for 2022/23 was 2.81%

## LEGAL IMPLICATIONS

29. The council is empowered to buy and sell land pursuant to section 120 of the Local Government Act 1972. Section 1 of the Local Government Act 2003 provides a power to the council to borrow for the purposes of any enactment.

30. In order to lawfully implement the investment strategy, each proposal (including the funding strategy for purchases) was reviewed as part of a decision to purchase and tested for both value for money and regulatory compliance. All acquisitions were reviewed by, or on behalf of, IWC to be able to maintain oversight of the transactions being completed.

## EQUALITY AND DIVERSITY

31. The council, as a public body, is required to meet its statutory obligations under the Equality Act 2010 and to have due regard to eliminate unlawful discrimination, promote equal opportunities between people from different groups, as well as foster good relations between people who share a protected characteristic and those who do not share it.

32. The protected characteristics are: age; disability; gender reassignment; marriage/civil partnership; pregnancy/ maternity; race, religion and/or belief; and sex/sexual orientation. It is not considered that the content of this report has any impact on any of the protected characteristics.

## RISK MANAGEMENT

33. All commercial property investments carry a risk. However, the commercial property investment strategy ensured that any risk was minimised in return for an appropriate level of financial gain. There are clear protocols, authorisation processes (overseen by the Director of Finance/Section 151 Officer) and due diligence checks in place that allowed for risks associated with the various acquisitions to be fully evaluated prior to sale completion. These protocols and processes will continue to be reviewed.

## EVALUATION

34. Full Council agreed the commercial property acquisition strategy in line with the medium-term financial strategy in order to secure an income stream that would contribute to the overall aim of future financial sustainability of the Island's public services.

## APPENDICES ATTACHED

Appendix 1 - Schedule of assets held

## BACKGROUND PAPERS

35. Full Council 20 September 2017 – Commercial Property as Investment – Paper C <https://www.iow.gov.uk/Meetings/committees/mod-council/20-9-17/Paper%20C.pdf>
36. Audit Committee 3 December 2018 – Progress Report Commercial Acquisition Strategy <https://www.iow.gov.uk/Meetings/committees/Audit%20Committee/3-12-18/PAPER%20J%20-%20Progress%20Report%20-%20Commercial%20Aquisition%20Strategy.pdf>
37. Audit Committee 30 September 2019 – Progress Report Commercial Acquisition Strategy – Paper G <https://www.iow.gov.uk/Meetings/committees/Audit%20Committee/30-9-19/PaperG-ProgressReport-PropertyAquisitionsStrategy.pdf>
38. Audit Committee 28 September 2020 – Progress Report Commercial Acquisition Strategy <https://iow.moderngov.co.uk/documents/s1029/Commercial%20Property%20Report.pdf>
39. Audit Committee 27 September 2021 – Progress Report Commercial Acquisition Strategy <https://iow.moderngov.co.uk/documents/s4626/Item%207%20-%20Commercial%20Acquisition%20Progress%20Report.pdf>  
<https://iow.moderngov.co.uk/documents/s4627/Item%207%20-%20Commercial%20Acquisition%20Progress%20-%20Appendix%201.pdf>
40. Audit Committee 25 July 2022 – Progress Report Commercial Acquisition Strategy <https://iow.moderngov.co.uk/documents/s8719/Item%208%20Property%20Investment%20Portfolio%20Annual%20Report.pdf>  
<https://iow.moderngov.co.uk/documents/s8720/Item%208%20Property%20Investment%20Portfolio%20Annual%20Report%20-%20Appendix%201.pdf>

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