



Purpose: For Noting

# Committee report

Committee	<b>AUDIT COMMITTEE</b>
Date	<b>27 SEPTEMBER 2021</b>
Title	<b>COMMERCIAL ACQUISITION STRATEGY PROGRESS REPORT</b>
Report of	<b>CABINET MEMBER FOR STRATEGIC FINANCE, CORPORATE RESOURCES AND TRANSFORMATIONAL CHANGE</b>

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## PURPOSE

1. This noting report provides members of the Audit Committee with an overall summary of progress in the delivery of the council's commercial property acquisition strategy up to 31 March 2021.

## BACKGROUND

2. 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 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.
3. The commercial property acquisition strategy approved by members in September 2017 has been used as the framework for all acquisitions. The approved strategy included strict criteria to be used when determining 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.
4. In 2018, the fund acquired four separate property investments comprising thirteen lettable units with nine tenants.
  5. Portsmouth City Council (PCC), as commissioned by Isle of Wight Council (IWC), was managing the property investment fund since its inception until 1 April 2021, after which time responsibility for management of the properties transferred to IWC's Property Services department.
  6. IWC's investment strategy has now settled into a management phase and it is no longer actively looking to acquire properties on the mainland.

## PROGRESS TO DATE

### 7. **Current fund - statistics**

- 7.1 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 as set out in paragraph 11.2), IWC spent around £35.1 million on investment acquisitions.
- 7.2 The investment properties were acquired in 2018.
- 7.3 The four investments comprise:
  - Olympic Court, Salford, Greater Manchester – acquired March 2018 for £10.8m;
  - Network 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.
- 7.4 Appendix 1 is a schedule of all assets currently held within the fund.

### 8. **Rental income**

- 8.1 Rental income across the portfolio has been consistent. Some tenants delayed payment in July 2020, but all rent has now been collected and no tenants are currently in arrears.
- 8.2 Lease events in the 12-month period up to 31 March 2021 included:
  - Nursling Industrial Estate, Southampton – unit relet to Metabo Ltd; and
  - Notice was received in September 2020 from Sunwin Services at Unit 4, Aylesford that they did not wish to renew their tenancy and they vacated in

January 2021. Although a new tenant was quickly identified and terms agreed, their financial position ultimately led to them having to pull out. The unit is currently vacant and being marketed with regional agents with a national reach.

8.3 The eight tenants currently in occupation are:

- **Salford, Greater Manchester**
  - In The Style Fashion Ltd
  - Mettler-Toledo Safeline Ltd
- **Oxford**
  - Nedschroef Ltd
  - Stagecoach Group
- **Aylesford, Kent**
  - Betterstore Self Storage Properties III Ltd
  - Eriks Industrial Services Ltd
  - Go Installations Ltd
  - One unit is vacant
- **Nursling, Southampton**
  - Metabo UK Ltd

8.4 Forthcoming lease events going into 2021/22 will include the following:

- Unit 4, Access 4:20, Aylesford - currently on the market with new letting expected; and
- Unit 5, Access 4:20, Aylesford - negotiating terms with Go Installations Ltd for a new lease.

## 9. **Strategy**

9.1 IWC is not looking to acquire any further investment properties.

9.2 With a stop on acquisition activity, the immediate focus for the portfolio is to manage the impact of the coronavirus pandemic on existing assets and tenants with a priority focus on continued cash-flow security and debt management. A careful and considered management approach will be necessary for any forthcoming lease events such as rent reviews and lease renewals to avoid protracted and costly court procedures and potential void risks.

9.3 Continuing to hold and actively manage these assets in the short to medium term whilst the wider implications associated with the economy are assessed is of upmost importance. In doing so, this will protect the Council's revenue position and allow the maximum opportunity for the revision of the investment strategy in due course.

## 10. **Investment market**

10.1 The demand for space from the UK's industrial and logistics sectors hit a record high in 2020 of 59.7 million sq ft (Source: Lambert Smith Hampton). While the pandemic suppressed demand in other parts of the property market,

it stimulated it for warehouse space with increased online retail activity encouraging major e-commerce businesses to push ahead with expansion plans.

- 10.2 Although Brexit was pushed down the headlines in 2020 by the pandemic, the ending of the transition period at the turn of the year brought it back into focus. While companies are still getting to grips with the new trading environment, the restructuring of supply chains may encourage even more demand for warehouse space, especially if companies decide to keep increased volumes of stock close to domestic customers.
- 10.3 In 2020, property returns across all sectors, comprising estimated rental growth, equivalent yield and capital growth were estimated to have fallen by as much as 4.5% (Source: Gerald Eve). This was largely driven by a decline in the retail and office sectors. However, positive rental growth and further yield compression is forecast to push annual returns for industrial to +7.9% in 2021 (Source: Gerald Eve).
- 10.4 While the pandemic has left economic scars that will take time to heal, a concerted consumer-driven recovery, supported by the record levels of household saving seen over the last year, is expected going forward. And, having already displayed remarkable resilience throughout the crisis, the demand for industrial and logistics property should grow as a result of structural changes that have been accelerated by the pandemic.

## 11. Resources

- 11.1 PCC managed the fund on behalf of IWC until 1 April 2021.
- 11.2 Fees paid to PCC between 1 April 2020 and 31 March 2021 for the provision of these services totalled £60,000. No acquisitions were made during this period and, therefore, no premium payments were made.
- 11.3 From 1 April 2021, IWC's Property Services department assumed complete responsibility for management of the fund.
- 11.4 At present, the fund is being managed within IWC's existing resources and this may have consequences for the deliverability of other priorities.
- 11.5 A revised business plan will need to be agreed to ensure that sufficient resources are made available to undertake the work required to manage the fund effectively.

## STRATEGIC CONTEXT

- 12. The commercial property acquisition fund is a feature of the council's medium-term financial strategy agreed by Full Council in October 2016. The subsequent commercial property acquisition strategy was approved by Full Council in September 2017. Both the fund and strategy are clearly aligned with the council's aim of *"ensuring that all the resources available to the Island are used in the most effective way in achieving the Island's priorities"*.

## FINANCIAL / BUDGET IMPLICATIONS

### 13. Capital growth

- 13.1 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.
- 13.2 The fund is valued annually on 31 March by an external valuer. Capital values are now measurable for the whole portfolio year-on-year from 1 April 2020 to 31 March 2021.

	March 2018 Value (£m)	March 2019 Value (£m)	March 2020 Value (£m)	March 2021 Value (£m)	Percentage +/- since 2018
Access 4:20 Aylesford, Kent	£8.625	£8.625	£8.625	£9.1	+5.51%
Olympic Court, Salford, Manchester	£10.8	£10.97	£10.97	£11.75	+8.8%
Network Oxford	N/A	£10.0	£10.0	£10.2	+2%
Metabo Nursling, Southampton	N/A	£3.5	£3.5	£4.0	+14.29%

### 14. Rental Income (Gross Return)

- 14.1 The total income received for the period 1 April 2020 to 31 March 2021 was £1.8m (rounded up). This represents a 12% annual increase to revenue.
- 14.2 Based on the acquisition price, the gross return up to 31 March 2020 was 4.53% and up to 31<sup>st</sup> March 2021 it was 5.08% (**N.B.** the income for 2021 did include an element of backdated rent).

### 15. Rental Income (Net Return)

- 15.1 The cumulative net income (excluding debt costs) to the council for the year to 31 March 2021 amounts to £1.666m, which represents income of £1.785m less costs of £0.119m. For the period between 1 April 2020 and 31 March 2021 this represents a return of 4.74%.
- 15.2 The council incurred costs of £0.073m relating to service charges which includes the management costs agreed under the strategic partnership with PCC of £0.06m and services provided by managing agents of £0.013m. Other operating costs incurred were £0.046m. The council incurred debt costs of £0.738m and contributed towards the commercial property reserve of £0.024m. This reserve will be used to fund potential lost rental income and future property related costs.
- 15.3 The net return (including debt costs) for 2020/21 prior to the reserve transfer was £0.928m, which represents a net yield of 2.64%.

## LEGAL IMPLICATIONS

16. 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.
17. 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 value for money, and regulatory compliance. All acquisitions were reviewed by IWC as a means to maintain oversight of transactions being completed.

## EQUALITY AND DIVERSITY

18. The council, as a public body, is required to meet its statutory obligations under the Equality Act 2010 to have due regard to eliminate unlawful discrimination, promote equal opportunities between people from different groups, and foster good relations between people who share a protected characteristic and people who do not share it. The protected characteristics are: age; disability; gender reassignment; marriage and civil partnership; pregnancy and maternity; race, religion and/or belief; sex and sexual orientation. It is not considered that the content of this report has any impact on any of the protected characteristics.

## RISK MANAGEMENT

19. 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 in response to the evolving impact of COVID-19 on commercial property performance.

## EVALUATION

20. Full Council agreed the commercial property acquisition strategy in line with the medium-term financial strategy in September 2017 in order to secure an income stream that would contribute to the overall aim of future financial sustainability of the Island's public services.

### RECOMMENDATION

21. To note the progress of the property investment fund in the delivery of the commercial property acquisition strategy, including the total income that has been accrued by the council.

## APPENDICES ATTACHED

Appendix 1: Schedule of assets held.

## BACKGROUND PAPERS

22. 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>
23. 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>
24. 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>
25. Audit Committee 28 September 2020 – Progress Report Commercial Acquisition Strategy  
<https://iow.moderngov.co.uk/documents/s1029/Commercial%20Property%20Report.pdf>

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