

Investment Assets Quarterly Update Report

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Purpose of the Report

1. To provide a quarterly update to members on progress with implementing the commercial investment component of the Commercial Strategy agreed by Council.

Forward Plan

2. This report appeared on the latest District Executive Forward Plan with an anticipated Committee date of March 2021. This report provides a quarterly update between the half-yearly reports, the frequency being increased in response to the COVID-19 pandemic.

Public Interest

- 3. The Council's commercial strategy forms an important part of the Council's Corporate Plan ("Council Plan") and its Financial Strategy. Delivery of the Commercial Strategy enables the council to protect services to residents in the light of reductions in funding and to deliver its ambitions for South Somerset, for example the regeneration of town centres and high streets.
- 4. This report is to update members on progress made to date on the Property Investment component of the Commercial Strategy. The Council originally agreed to receive updates on progress every six months with the most recent update being reported in December 2020. District Executive decided to receive quarterly summary update reports on Investment Assets until further notice in light of the economic effects of the COVID-19 pandemic. These reports have reduced levels of detail.
- 5. The report includes updates on rent collection, tenancies, the financial performance of investments, the purchasing of new commercial investments, and progress with projects.
- 6. These contribute to delivery of the objectives of SSDC's Financial Strategy originally agreed in September 2017 and the Commercial Strategy agreed in



August 2017, and updated with the review by District Executive and Full Council of the Financial Strategy and Commercial Strategy in September 2019.

- 7. The aim of this report is to give Members and the public an update on the performance and impact of the commercial investment to date including its contribution to mitigating the impact of reductions in Government funding and protecting services.
- Due to the sensitive commercial nature of investment acquisitions, and the need to manage risk and protect the value of the Council's investments over the long term, certain detailed information is included in a confidential appendix and not to be disclosed.

Recommendations

- 9. That the District Executive:
 - a. Note the resilience of the property investment portfolio thus far in the context of the COVID-19 pandemic.
 - b. Note progress made to date in acquiring new commercial investments and the asset management following acquisition.
 - c. Note continued rent collection averaging in excess of 95% over the last three Quarters despite the pandemic.
 - d. Note the return being achieved across the portfolio which is slightly below the Council's target of 7% as a result of lease renewals, securing the future of the asset.
 - e. Note progress being made in securing income from our existing assets and the contribution to the revenue budget towards the revised £3.35m target.

Background

- 10. While presenting the "Commercial Services Income Update" report to District Executive in February 2018, members requested regular updates to show progress made in meeting the Commercial Strategy (approved by Council in August 2017). These detailed reports have normally been provided at six monthly intervals but are now to be presented quarterly with a summary report in between the full six monthly reports.
- 11. This report is a succinct update of high level figures for new investments since November 2020, updated to 31 January 2021 with commentary on the management of the investment property assets.
- 12. The Commercial Property Team has been stable in terms of staffing since the last report.



COVID-19

- 13. The impact of the pandemic on all of society and affecting economies across the world is well known. The UK saw GDP fall by 9.9% in 2020. The fall in 2020 was more than twice the next largest fall of 4.0% in 2009, driven by significantly weaker growth from services. The economy grew by 1.2% in December, after shrinking by 2.3% in November, as some restrictions eased. January 2021 is expected to show a further fall due to the latest lockdown but recovery may then start to occur. Forecasts are currently suggesting that the economy will revive in 2021 but that full recovery may not be achieved until the end of 2022. This suggests that economic growth would return to trend after that.
- 14. Headlines about the economic situation have pointed to a period which sees recession of a scale that would be measured as being one of the worst ever. However, the economy is hugely complex. The extent of fall in GDP is undeniably a vital measure but the pandemic and lockdowns as reasons for the fall also point to the potential for the recovery to be swifter than some past recessions and the impact in property investment market terms to be less severe than the stark headlines might suggest.
- 15. The property investment market, like much of the economy, closed down to a large degree in Q2 2020 with the volume of investment overall being reduced by 79% below the 5-year quarter average. Since then, volumes have progressively recovered. The overall position for the year in 2020 was that investment volumes were 22% down on 2019 which shows a relatively strong performance later in the year.
- 16. Investment property values and prices have moved with the changing markets. The industrial and distribution sector continues to be strongly sought after by investors. There has been major take-up of floorspace, often by online retailers. Investment prices have risen appreciably which makes it harder for us to achieve purchases where risk is acceptable whilst meeting our target yield. Offices overall have held their values stable with the best opportunities rising in price but secondary values weakening against an expectation there will be an overall reduction in demand due to the acceleration of flexible working. Within retail, supermarkets have strengthened in value, bulky goods retail warehousing held stable but high street retail has continued to lose value a trend that has continued for several years, and is likely to continue as lease contracts take time to expire.



Rent collections

- 17. Most commercial property leases provide for rent to be paid quarterly in advance in March, June, September and December. We have therefore had four rent quarter days since the initial outbreak. The March quarter day (25th March) was only two days after the initial lockdown began. A number of retail and leisure based funds and landowners were substantially affected by major reductions in the proportion of contracted rents actually being paid.
- 18. Our rent collection across the investment property portfolio in total was broadly unaffected, with collection figures of 98%, although the timing for payments has been longer and there has been a need for much more liaison with tenants. Our team has focussed attention on the connection with our tenants. We have sought to show appropriate flexibility as part of a supportive attitude, but also to protect the Council's investments.
- 19. The December 2020 quarter collections are not yet completed with around 76% collected thus far. Our analysis leads us to forecast that we will again collect 98% of the rents due in total.
- 20. We will continue to maintain close contact with tenants and help where we reasonably can.

New Assets

- 21. We have not acquired any commercial properties over the course of the last six months.
- 22. Borrowing of up to £150m has been agreed and there is a strategy in place for a portfolio of that size. The development of a commercial investment fund as a means of generating income is agreed by the Council and we will continue to seek new opportunities for investment. Including Battery Energy Storage Sites (BESS), the total sum invested and committed stands at £120m. This figure includes two properties where we have approval in principle. We are completing detailed due diligence and legal work required to conclude the purchases. The market remains quieter, although, with progress with the vaccine, there are indications that it may improve. We are aware of a number of properties being offered to the market in the coming months.
- 23. Net Gain to Revenue contribution for 2020/21 from this programme is forecast to be about £2m.
- 24. Where properties are coming to the market, we have noticed a discount on leisure, office, and in particular High Street retail assets. Conversely, the demand for



industrial properties has seen yields harden, to the point where it is difficult to find any quality at our required net initial yield of 7%.

- 25. The portfolio has a full allocation of offices, industrial/distribution property is strongly competed for at rising prices, and High Street retail property has hidden risks as we cannot see how far the rental market will fall. Therefore, we have been focusing on alternative sectors. We currently have a data centre in the Midlands under offer at circa £2.5m, a leisure facility within an industrial building on the South Coast under offer at circa £2.5m and a food production facility in the South West under offer at circa £6.5m.
- 26. Any investment we do make will undergo rigorous due diligence due to market conditions, including close attention to the tenant covenant.
- 27. We have contractually secured a further renewable energy asset a 40 MW Battery Energy Storage Site at Fareham. The investment is structured in the form of a loan to our JV company SSDC Opium Power Limited and will be project managed through the construction phase, and then operated and managed by the JV company. Despite the additional regulations brought about by the pandemic, work has commenced on site in January. Future reports will provide an update on progress. The facility is expected to be completed and trading before the end of the year.
- 28. Half yearly reports have included graphs indicating actual progress against budget for income and for capital invested. These are not produced for the quarterly updates in order to save the officer time involved in updating. Tables of financial detail are included in the confidential appendix.

Portfolio Management Update

29. A number of specific management transactions are included in the Confidential Appendix. The information is provided there to protect not only the council's commercial position but also recognising the involvement of other parties in these matters.

Financial Implications

- 30. The financial implications for the progress with commercial investments are set out above within the report and also in further detail in the Confidential Appendix.
- 31.SSDC has approved a large sum for commercial investment. The commercial strategy has been operating for 42 months, and excellent progress has been made, ahead of target timeframes.
- 32. The Marlborough residential development has been considerably delayed against original programme as reported previously, COVID-19 disrupting both completion

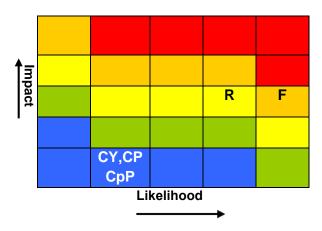


of outstanding work and marketing activity. We have appointed new selling agents. Two houses are close to sales being concluded. We are hopeful that the end of lockdown will see the market pick up, and Marlborough as a location is expected to perform well. We will report back with progress in due course.

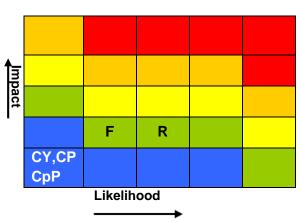
- 33. The summary position is gross receipts were achieved for 2019/20 financial year of £3,456,525 producing a net gain to revenue of £491,709. The estimate for 2020/21 financial year is gross receipts of £5,129,051 and net gain to revenue of £1,959,182. For the completed Fideoak BESS project, net income is currently over £100,000 per month with increases expected as Phase 2 comes online in February 2021 and in March when the new Dynamic Containment market starts. Dynamic Containment is an improvement to the electricity supply industry which helps improve performance as more reliance is placed on renewable energy, and provides an additional market for BESS storage infrastructure.
- 34. Detailed and robust due diligence has been completed with extensive involvement of SSDC's finance and legal specialists together with external advisors (e.g. valuers, tax specialists, legal advisers, sector specialists) to support the property team in completing robust business cases that underpin recommendations and investment decisions. The decisions made have been through the agreed governance arrangements as approved by SSDC with the Investment Assessment Group providing deferrals, refusals and unanimous recommendations to the Council Leader and Chief Executive for final decisions. Arrangements have been reviewed by Internal Audit and the minor improvements recommended have been implemented.
- 35. The financial implications of completed acquisitions including costs, income and funding arrangements will continue to be incorporated in budget setting and monitoring processes, in line with SSDC's financial procedures framework.

Risk Matrix

Risk Profile before officer recommendations



Risk Profile after officer recommendations





Key

Categories				Colours (for further detail please refer to Risk				
			management strategy)					
R	=	Reputation		Red	=	High impact and	high pro	bability
СрР	=	Corporate	Plan	Orange	=	Major impact and	d major p	robability
Priorities				Yellow	=	Moderate impac	ct and r	noderate
CP	=	Community Price			probability			
CY	=	Capacity	Green	=	Minor impact and minor probability			
F	=	Financial		Blue	=	Insignificant	impact	and
					insignificant probability			

Council Plan Implications

36. This report links to the following Council Plan objectives:

- Protecting Core Services
- Take a more commercial approach to become self-sufficient financially
- Supporting the Regeneration of Chard, Yeovil and Wincanton
- Supporting local businesses

Carbon Emissions and Climate Change Implications

37. The council reviews energy performance as part of its purchase due diligence and seeks opportunities for improvement of this with assets it owns. We are prioritising work to identify projects of environmental benefit.

Equality and Diversity Implications

38. This report does not involve any equality or diversity implications

Privacy Impact Assessment

39. There is no personal information included in this report

Background Papers

SSDC Commercial Strategy 2017 and 2019