South Somerset District Council

Investment Asset Update Report

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Purpose of the Report

1. To provide an update to members and the public on performance of the commercial investments owned by the Council since the last half yearly update reported in March 2022.

Forward Plan

2. This report appeared on the latest District Executive Forward Plan with an anticipated Committee date of June 2022.

Public Interest

3. The Council approved substantial capital funding for the acquisition of commercial investments. Measured by financial scale, this was the major component of the Council's Commercial Strategy. The objective was to enable the Council to protect services to residents in the light of reduction in funding. The Council agreed to receive updates on progress every six months.

Recommendations

4. That District Executive:-

   a. Note the continuing performance of the commercial investments of the Council
   b. Note the return being achieved across the portfolio which is in line with the Council's target of 7%.

Background

5. Council approved a commercial approach to Land and Property management in August 2017 as part of the Commercial Strategy which was supporting the objective of becoming financially self-sufficient.

6. The commercial approach to Land and Property management is the major financial component of the Commercial Strategy. The objectives are to invest in additional commercial property assets and to manage existing land and property assets more commercially. The underlying objective continues to be to deliver a net return to the bottom line for frontline services of 3% from the capital invested.

7. Members requested regular updates to show progress made in meeting the Commercial Strategy.

8. The funding for commercial investment was increased by the Council in September 2019. New acquisition of additional commercial investments was ceased by a decision of District Executive in December 2021.

9. This report includes income data up to the end of April 2022.

Investment overview

10. A total sum of £142m has been invested by the Council via the acquisition of commercial asset investments with the aim of providing a net income return to the Council on a sustained long term basis. The investment assets split into three segments measured by the amounts invested:

Commercial investment property	93,440,498	66.0%
Renewable energy projects	43,487,058	30.7%
Residential development	4,727,375	3.3%
Total invested	**141,654,931**	**100.0%**

11. These investment segments are reported on separately in the sections that follow.

Commercial investment property

12. A total of 21 separate properties have been acquired. These are reasonably spread geographically and also in terms of the uses of the properties. The rental income is derived from 43 separate tenancies. This further contributes to the portfolio spread. The lot sizes by property and tenant balance this resilience due to the spread of investments while limiting the intensity and cost of management. No further acquisition activity has been carried out, in line with the District Executive decision that the acquisition phase has been concluded.

13. The portfolio is summarised:

		Portfolio	Retail	Industrial	Office	Alternative	Leisure & Hospitality
Capital Values	Asset Value (£'000)	£93,549	£23,028	£23,914	£27,036	£16,129	£3,442
	Portfolio Split (%)	100	25	26	29	17	4
Income	Total Income (£'000 pa)	£6,448.12	£1,815.61	£1,650.36	£1,762.96	£941.43	£277.76

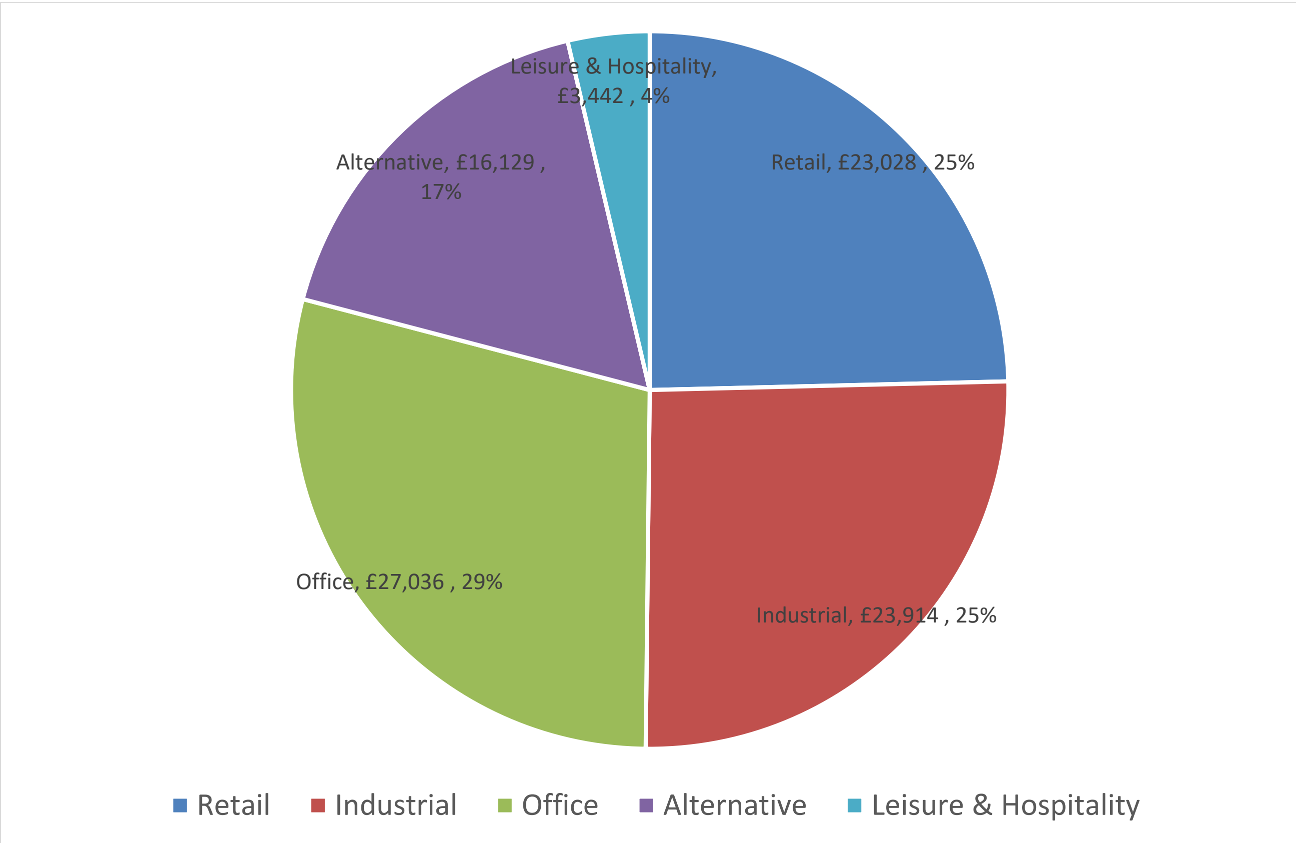
	Portfolio Split (%)	100	28	26	27	15	4
Metrics	Assets	21	4	6	5	3	3
	Yield (%)	6.9%	7.9%	6.9%	6.5%	5.8%	8.1%
	Av Income per asset (£'000 pa)	£307	£454	£275	£353	£314	£93
	WAULT	7.11	4.97	4.04	4.58	24.02	15.42

Notes –

1. WAULT stands for weighted average unexpired lease term and is the period in years for the average contractual lease commitments, weighted according to the amount of rent on each lease.

2. Alternative as a category for investment property sector, refers to uses that do not fall into the other categories. These may be in education, healthcare, land or specialised uses. For the SSDC portfolio the actual uses are – veterinary hospital, hospital food preparation, and data server facility. While these current uses are specialised, the buildings that accommodate them are standard – either officers or industrial.

14. Sector split chart



15. The target set in the Commercial Strategy was for investments to achieve a gross property yield on average of 7.0%. The current overall portfolio yield is just below target

at 6.9%. The restructure package on one property agreed in response to COVID business pressures on our tenant is still working through the cashflow in the period used (2021/22) but will have concluded in 2022/23 which will see the overall return above 7.0%.

16. The main aim is to deliver income from these investments. The current total income receivable is 98.9% of the income budget when the acquisitions were each approved. The reasons this is slightly down on budget are that there are vacant unlet units at two properties and in three other instances rent free incentives have been allowed as part of letting transactions. Conclusion of the rent free incentives will see total receivable rents above the budget aggregate level. Longer term income expectations can be monitored by reference to estimated market rental value (ERV). This is the opinion of the rent that should be achieved on re-letting of each lettable unit. The total ERV is 94.6% of the income budget when the acquisitions were each approved. Three properties were purchased on the basis this eventual ERV would be lower than the rent due under the lease in place. For the two retail properties we own in Yeovil, the ERV has fallen further since purchase. For all other properties, the ERV is either unchanged or increased since purchase.

17. The UK economy, along with many other major economies has experienced a sharp increase in the rate of inflation with CPI rising by 9.1% in the 12 months to May 2022, far above the inflation target of 2%. This impacts on the cost of council services and on capital projects. There is no automatic relationship to the income returns from investment property. Over the last 50 years, there have been differences between the patterns of rental income growth and general inflation. However, over medium term periods (10-15 years) the general pattern has been for rental income growth to keep pace with general inflation.

Renewable energy projects

18. The Council has invested £43.5m in battery energy storage systems (BESS) - Taunton (Fideoak) and Fareham (FERL 1&2) through a joint venture company: SSDC Opium Power Ltd. The returns from these to SSDC come by way of interest on capital lent to the joint venture company, repayment of capital, and dividends from the profits of the company. As these projects must first be constructed, there is an initial period of investment without immediate return. Taunton was completed in 2020, FERL 1 was completed in February 2022 and FERL 2 has reached completion in June 2022.

19. BESS contributes to renewable electricity supply by electricity storage - enabling power generated by renewable sources to be stored until needed. The commercial return on the capital invested is achieved because the market for this sector offers a higher price to buy stored power than the cost it sells surplus at.

20. The Fideoak BESS continues to be fully operational and revenue producing. The system has continued to be operated by SSDC OPL in the most lucrative Stability

Services market - the Dynamic Containment (DC) market. This is the highest earning market for Grid Scale Batteries, and as such has the most challenging technical requirements that must be met in respect of power delivery reaction time, accuracy of metering, stability of power delivery, and consistency of service availability.

21. The figures in the table below include actual income received from April 2021 to March 2022. All the sums are the gross income received by the joint venture company and do not represent net income to SSDC.

Month	£
April	209,773.23
May	252,656.35
June	288,995.95
July	314,041.23
August	307,404.91
September	284,157.66
October	317,016.00
November	48,492.18
December	119,389.46
January	169,879.15
February	418,360.74
March	115,854.88
2021/22 Total	**2,846,021.74**

22. The National Grid has a 45-day payment policy, therefore revenue for May is not received until the end of July, June until the end of August and so on. From a cashflow perspective the company will be at least two months behind the actual generation.

23. On 1 November 2021 Limejump replaced Kiwi Power as the optimiser for the site. Limejump will also be optimising the 40mw and 20mw Fareham BESS. The optimiser's role is to control and dispatch the battery asset into the National Grid's energy marketplace in order to maximise revenue for the site.

Fareham Project update

24. The Fareham 40mw Phase 1 was energised in February 2022 and following live commissioning it qualified into National Grid's FFR (Frequency Stabilisation service provision marketplace) in March and then as planned rapidly qualified into the most lucrative National Grid Dynamic Containment service marketplace in April. The site is fully operational. Provisional revenue earning figures for Fareham Phase 1 for April 2022 is in the region of £144k.

25. The construction delivery of Fareham 20mw Phase 2 BESS is complete, on budget and confirmed for connection to the substation four months ahead of schedule. The

connection and energisation date has been confirmed as the 19 July 2022. Final live commissioning takes place once the site is energised, and revenue earning operations are targeted to initiate by the end of August.

Residential Development, Marlborough

26. The Marlborough residential development comprises 3 new build houses and 15 flats created by refurbishment of an existing building. The project has been considerably delayed against original programme as reported previously, COVID-19 disrupting both completion of outstanding work and marketing activity. These delays and other detailed aspects of results compared with budgets means that this project is not expected to deliver any profit when all is finalised.

27. Good progress is being continued with sales. Three houses and four flat sales have now completed returning to the Council 42% of the expected gross value. A further six flats are under offer and in solicitors hands. There is a good level of interest in the flats generally. We consider progress with securing buyer is now good and we are expecting to continue good progress with the sales in the coming months.

Investment Strategy

28. With the decision to stop the build up of the portfolio by new acquisition, the focus is now on portfolio and property management. We aim to maintain the lowest level of tenancy voids possible, and to protect and increase medium to long term growth in value of individual properties and the portfolio.

Financial Implications

29. The financial implications for the progress with commercial investments and of asset management activity are set out within the report and in further detail in the Confidential Appendix where the detail impacts on our commercial relationships with tenants or other parties.

30. Detailed and robust due diligence has been completed on all projects 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 acquisition decisions made have been through the agreed governance arrangements as approved by SSDC with the Investment Assessment Group (IAG) providing deferrals, refusals and unanimous recommendations to the Council Leader and Chief Executive for final decisions. Arrangements have been

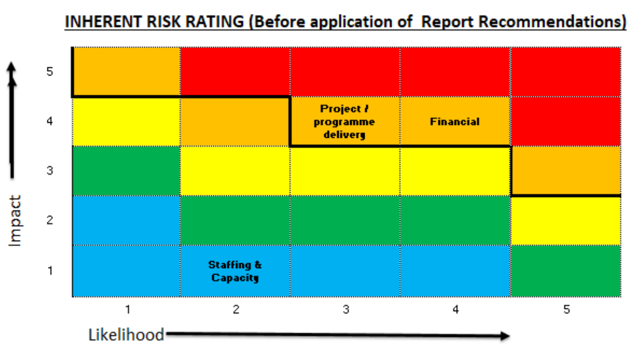
reviewed by Internal Audit and the minor improvements recommended have been implemented.

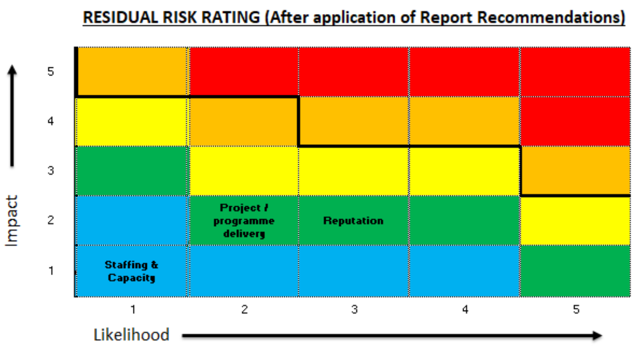
31. The financial implications of completed acquisitions including costs, income and funding arrangements will continue to be incorporated in budget setting and monitoring processes, in line with SSDC's financial procedures framework.

Legal implications (if any) and details of Statutory Powers

32. None.

Risk Matrix





Risk Ref	Risk Category	Inherent Risk Ratin	esidual Risk Rating	Risk Description	Mediation / Controls
1	**Project / programme delivery**	19	8	Requirement to meet delivery objectives in quantum and timing	Monitoring, resourcing and management
2	**Financial**	20	8	Income returns relative to target; change in capital or rental values	Due diligence on all transactions; expert team
3	**Staffing & Capacity**	3	1	Commercial property team and demands on other service teams (Finance and Legal)	Monitoring, management and priorisation of resources
4	**Reputation**	19	9	Damage to reputation linked to outcomes, business sectors of tenants or handling of management	Decision making criteria
5	**Governance & Legal**	3	1	Compliance with approved governance for decision making and implementing internal audit	Clear governance documentation, regular audit and reporting

Council Plan Implications

33. 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

34. None.

Equality and Diversity Implications

35. None.

Privacy Impact Assessment

36. There is no personal information included in this report

Background Papers

37. SSDC Commercial Strategy 2017 and 2019