Report No.

London Borough of Bromley

PART ONE - PUBLIC

Decision Maker:	**EXECUTIVE, RESOURCES AND CONTRACTS PDS COMMITTEE**
Date:	**Monday 7 February 2022**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**PROPERTY INVESTMENT PORTFOLIO UPDATE**
Contact Officer:	Amy Milton, Head of Estates & Asset Management Tel: 020 8461 7172 E-mail: amy.milton@bromley.gov.uk
Chief Officer:	Director of Housing, Planning, Property and Regeneration
Ward:	ALL

1. REASON(S) FOR THE REPORT

The Council's Estates Team report annually to the ERC PDS on the Council's Property Investment Portfolio for Members to note.

In July 2020 the Leader made the Executive Decision that a full asset management approach to the Investment Portfolio be adopted by seeking to award a contract for the full management of the portfolio to a suitably experienced and qualified firm of Chartered Surveyors. In April 2021, following a competitive tender process, Montagu Evans firm of Chartered Surveyors were appointed as the Council's Investment Portfolio Advisors.

This report provides an overview of the work undertaken to date by the Council's appointed advisors and sets out the Investment Strategy that will provide the overarching governance for the effective management of the portfolio.

A further report will be bought to the Executive Committee in due course, providing recommendations on the Key Performance Indicators and individual asset plans to be adopted to ensure robust governance is in place to deliver on the Investment Strategy.

2. RECOMMENDATION(S)

2.1 Members are asked to note the contents of this report.

Impact on Vulnerable Adults and Children

1. Summary of Impact: N/A

Corporate Policy

1. Policy Status: Existing Policy
2. BBB Priority: Excellent Council

Financial

1. Cost of proposal: n/a
2. Ongoing costs: n/a
3. Budget head/performance centre: Investment Income
4. Total current budget for this head: £5.2m
5. Source of funding: Existing revenue budget 2021/22

Personnel

1. Number of staff (current and additional): Not applicable
2. If from existing staff resources, number of staff hours: Not applicable

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Legal

1. Legal Requirement: Statutory Requirement
2. Call-in: Applicable

Procurement

1. Summary of Procurement Implications: Not applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): Not Applicable

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A
2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

Executive Summary

3.1.1 The London Borough of Bromley's investment portfolio comprises an investment fund totalling 21 assets with a total value of circa £60m which currently generates in the region of £4.7m pa, with a running yield of 5.27% (this was previously £5.2m and 6.04%, respectively prior to Arcadia's administration).

3.1.2 Following the Executive decision in July 2020, a competitive tender process has been undertaken, and Montagu Evans firm of Chartered Surveyors have been appointed as the Council's investment portfolio advisors for the next four years.

3.1.3 Analysis of the portfolios current performance demonstrates resilience to the challenges of the market at present, and the portfolio is outperforming a number of other similar portfolios held by institutional investors and other Local Authorities.

3.1.4 However, it is recognised that the Council's portfolio is heavily weighted towards more challenging asset classes such as High Street Retail, and it is critical that a robust Investment Strategy is adopted that drives the individual asset management strategies to ensure optimal performance of the Council's investments in the short, medium, and long term.

3.1.5 The adoption of the new Investment Strategy will guide the next stage of work which is the recommendation of Key Performance Indicators that should be adopted to measure the performance of the portfolio against short-, medium- and long-term objectives of the Council.

3.1.6 A further report will be bought to the Executive Committee in due course, with recommendations as to the Investment Strategy and KPI's that should be adopted to ensure robust governance and decision-making criteria are in place to effectively deliver on the Council's objectives. Within this report, individual asset plans will be provided, supported by cash flow modelling of anticipated portfolio performance over the next 8 years (up to 2030).

3.2 Investment Portfolio Overview

3.2.1 The London Borough of Bromley investment portfolio comprises an investment fund totalling 20 assets with a total value of circa £60m which currently generates in the region of £4.7m pa, with a running yield of 5.27% (this was previously 6.04% prior to Arcadia's administration).

3.2.2 These 20 assets were purchased, as per the definition of a Property Investment within the International Public Sector Accounting Standard and are now held in order to generate an alternative revenue stream for the Council.

3.2.3 A list of the 20 assets is provided below:

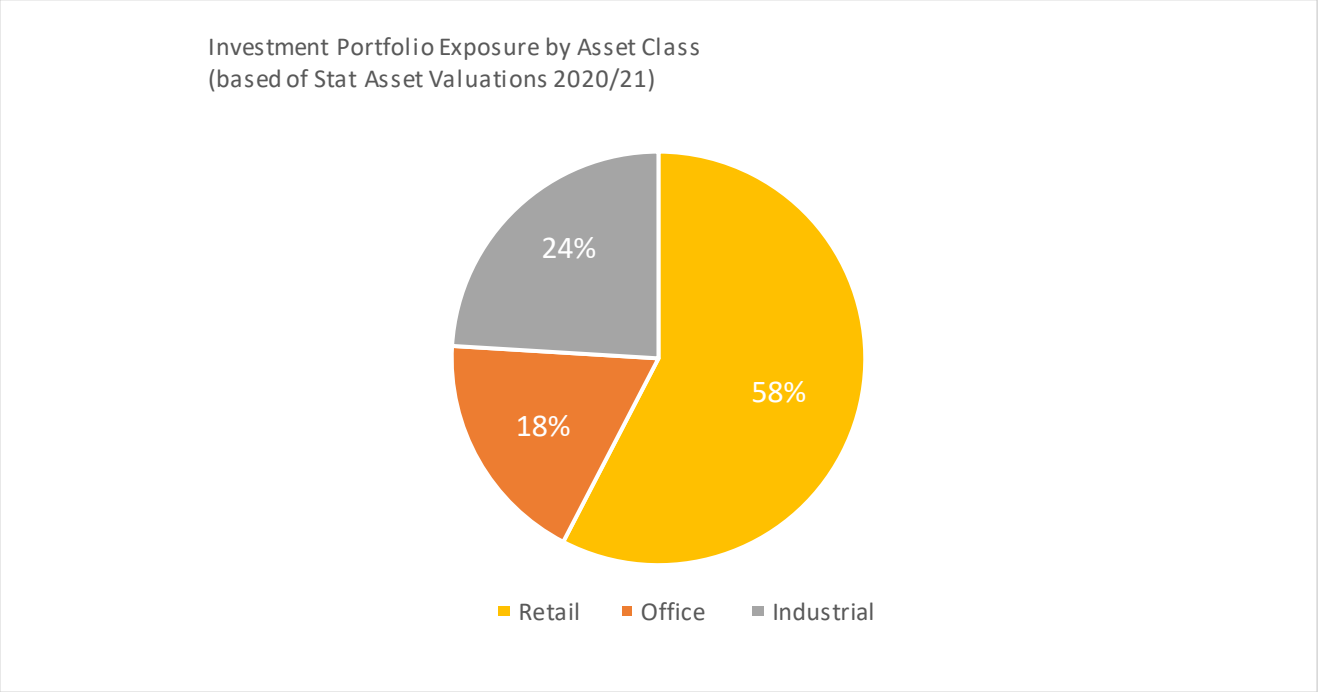
- 95 High Street, Bromley
- 98 High Street, Bromley
- 145 High Street, Bromley
- 147 High Street, Bromley
- 149 High Street, Bromley
- 151-153 High Street, Bromley

- 104-108 High Street, Bromley
- 27 Homesdale Road, Bromley
- Supermarket, St Francis Way, Shefford
- 33-35 Christchurch Road, Bournemouth
- 4 Tilgate Business Park, Brighton Road, Crawley
- Unit G, Hubert Road, Brentwood
- 1 Newbury House, 20 Kings Road, West Newbury
- Training Centre, Colthrop Way, Thatcham
- Unit C2, Southwood Summit Centre, Farnborough
- Unit C3, Southwood Summit Centre, Farnborough
- Trinity House, Eureka Park, Ashford
- Unit 1, 54 Bridge Street, Peterborough
- 63 The Walnuts, Orpington
- Market Square, Bromley
- *The Glades, Bromley (freehold and share of leasehold – this asset is held within the Investment Fund and managed accordingly, but is not included within value/revenue calculations due to fixed rent period)*

3.2.4 The contents on this report relates to the investment fund as set out above, but it should be noted that in addition, the Council also owns a number of other income generating properties that are held outside of the investment fund. For the avoidance of doubt, any reference to the investment fund or portfolio within this report only relates to the 20 assets mentioned above.

3.1.3 The investment portfolio comprises a mix of property types including offices, industrial and retail units which are primarily (but not all) let to a single tenant.

3.1.4 As shown below, the portfolio is heavily weighted towards retail assets:



3.3 Effective Management of the Investment Portfolio – Appointment of Advisor

3.3.1 Members will recall that the Leader made the Executive decision, following scrutiny by this committee, on 10 July 2020 to the following:

1) That a full asset management approach to the Investment Portfolio be adopted by seeking to award a contract for the full management of the portfolio to a suitably experienced and qualified firm of Chartered Surveyors.
(2) Proceeding to procurement for provision of asset management services via a further competition using the Crown Commercial Services Framework for a proposed duration of 3 years with a 1 year extension be approved.
(3) The creation of a new Property Investment Advisory Board (Members and Officers) be approved, with authority delegated to the Director of Housing, Planning and Regeneration in consultation with the Portfolio Holder for Resources, Commissioning and Contract Management to approve investment plans for the portfolio and also give authority to the contracted firm of Chartered Surveyors to action said plans.
(4) Councillor Gareth Allatt be invited to become a member of this Board.

3.3.2 In February 2021 a report relating to the Investment Portfolio was bought before the ERC PDS setting out the Council's scope of works to be tendered in relation to appointing a specialist Investment Portfolio advisor to review the portfolio and advise on the strategic plan that will balance the Council's exposure to risk and ensure the optimal performance of the portfolio in the short, medium and long term to best meet the objectives of the Council.

3.3.3 The scope of works was broken down into three separate stages as follows:

- Initial portfolio review & analysis
- Setting the strategic plan (Investment Strategy, KPIs, individual asset plans)
- 6 monthly reviews

3.3.4 Following a competitive tender process Montagu Evans, a firm of Chartered Surveyors, were appointed as the Councils Investment Portfolio Advisors and are now circa 9 months into delivering the 4-year programme.

3.3.5 This report provides the headline outputs from the first stage of the programme, with a further report to be bought to the Executive Committee, detailing the outcomes of the future stages of work and making recommendations as to the Investment Strategy, KPIs, and individual asset plans that should be adopted to support optimal performance going forwards.

3.4 Economic Overview

3.4.1 2020 and 2021 were characterised by unprecedented turmoil as the Coronavirus spread across the globe, and a global pandemic was declared. Even the most robust economies could not withstand the effects of the pandemic. The UK economy contracted 9.9% in 2020 as the Government responded to the pandemic by issuing mandatory national lockdowns. Whilst the general sentiment is that the pandemic has had a detrimental impact on the majority of the economic, some parts have fared better than others.

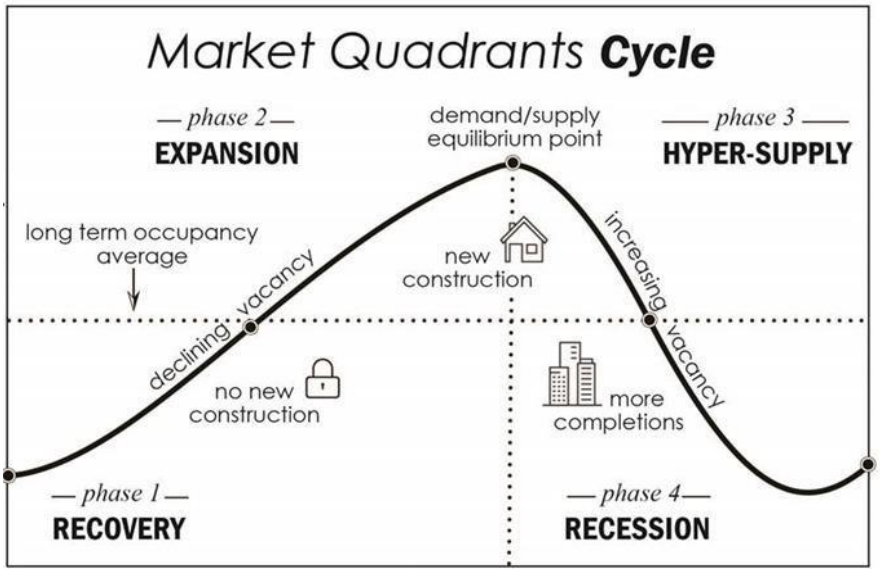
3.4.2 Many commentators are now of the view that the UK is coming through the other side of the pandemic and the recession. The UK's strong recovery has been helped by the rapid and efficient roll-out of the vaccination programme.

3.4.3 In May 2021, the Bank of England forecast that the UK will reach its fastest growth rate in over 70 years and has revised its overall forecast for 2021 total GDP growth to 7.5%, up from the previously forecasted 5% in February of 2021. As the chart shows, economists are increasingly bullish about the prospects for the UK economy over 2021/22 with only the Office for Budgetary Responsibility (OBR) maintaining its 5% growth estimate. This recovery rate would have taken the UK back to the level of output that it had at the end of 2019 by the end of this 2021.

3.4.4 However, now in Q1 2022, growth forecasts are being revised back downwards with a prediction that a rise in prices that could push inflation above 5%. More recent economic growth forecasts suggest a more modest 4.7% growth in 2022 is anticipated before slowing sharply in 2023 to just 1.7% growth

3.5 Property Market Cycle Context

3.5.1 Real estate and economic cycles are reoccurring and interdependent events. Real estate cycles have been a significant underlying reason for the financial successes and failures of real estate investments throughout history. They have an impact on returns, risks and values over time.

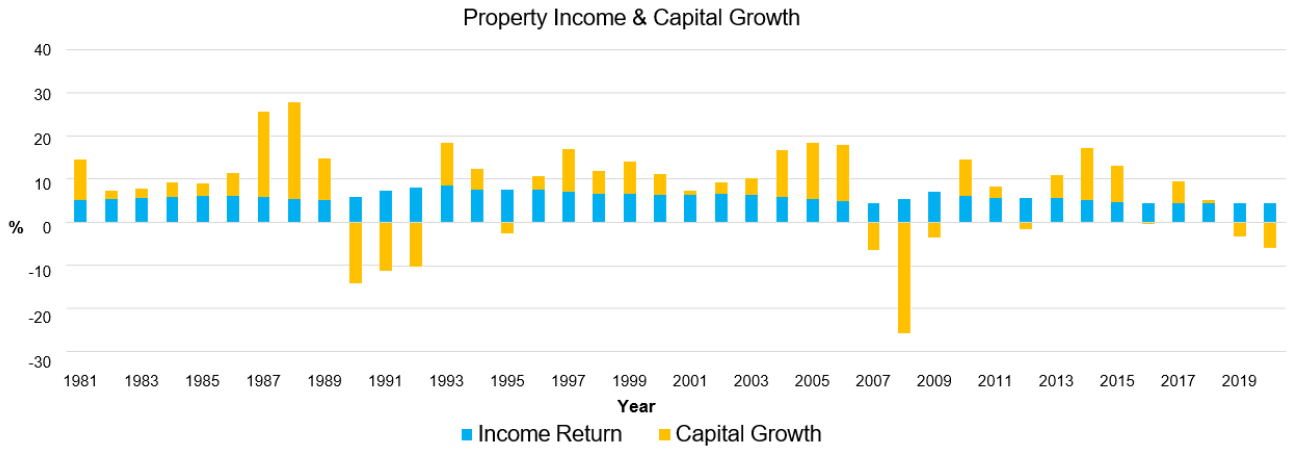


3.5.2 Currently, research places the UK in Phase 1 of the cycle, the recovery phase. At the beginning of this phase, market fundamentals are largely aligned with those seen in the recessionary

stages of the cycle. Here, the market is at the 'bottom', requiring time to recover from where values have been impacted the greatest.

3.5.3 As the real estate cycle continues through the recovery and expansion phases, an upward pressure on pricing starts to occur. This typically affects both rental and capital values. However, a point is reached whereby the pressure on pricing is so extreme that the corresponding increase in value, in overall terms, is no longer achieved. Along with other factors, a stage of "Hyper-Supply" occurs which subsequently leads to the final stage of the cycle, the recession phase.

3.5.4 Raw data derived from the MSCI database has been analysed, allowing the cyclical nature of the market to be clearly visualised as shown below. Income returns and capital growth, when viewed in conjunction, display the historical trend of Recovery, Expansion, Hyper-Supply and Recession. The latest annual data from 2020 across all property sectors places the UK at the bottom of the real estate cycle



Source: MSCI, analysis Montagu Evans (2021)

3.6 Property Sub-Markets Performance & Portfolio Composition

3.6.1 We have already identified that the UK property market is within phase one 'recovery' of the property market cycle which sets the macro picture of both the property market and the economy. However, it is also important to understand the performance of sub-markets that comprise the property market.

3.6.2 The market context provides a rationale to the challenges that some assets are facing and will ultimately inform the strategic direction of the portfolio. A RAG (red, amber, green) rating has been assigned to each of the sub-markets giving a high-level overview of how that market is performing. The RAG ratings are applied according to the general sentiment within the current market:

3.6.3 RAG key:

RED – relatively volatile market illustrating declining rents, increasing yields and structural changes impacting the financial stability of tenants. Opportunities for value add and redevelopment, but with higher risk

AMBER – Market is going through a period of change and there is a degree of instability across the sector. Rents and values are relatively stable although the medium to longer term horizon is less certain

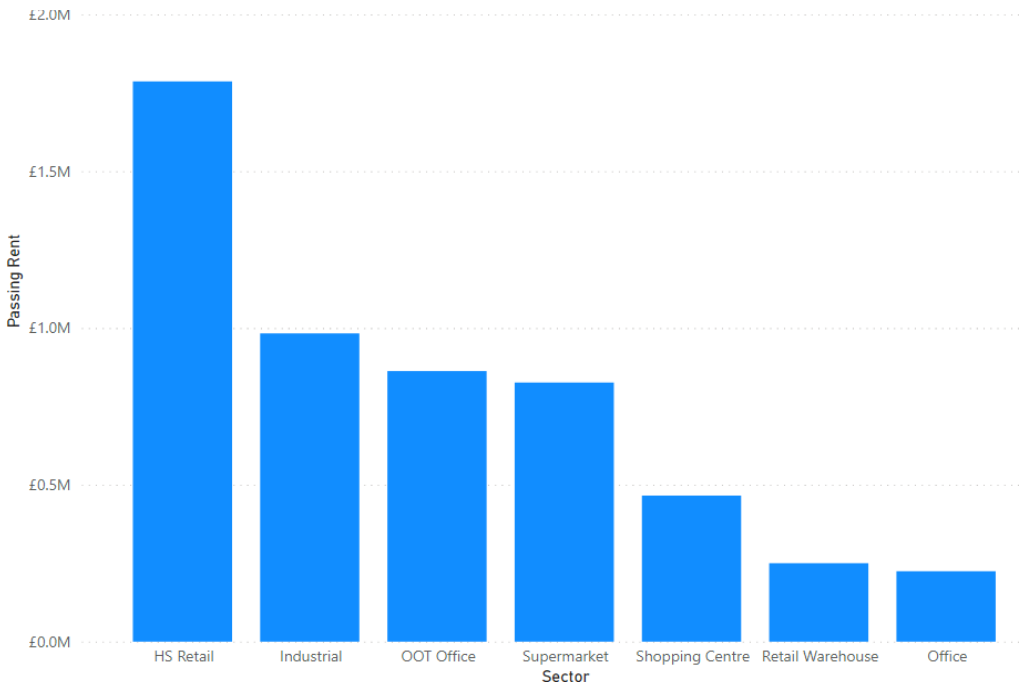
GREEN – Relatively stable sector with buoyant rents, values, and an active investment market. Lower risk and opportunities to profit take.

3.6.4 Summary RAG Status for different property sub sectors:

Sub Sector	Market Sentiment RAG Status
High Street Retail	
Retail Warehousing	
Supermarkets	
Shopping Centres	
Offices	
Industrial	

3.6.5 A more detailed analysis of the market evidence and performance trends to support these RAG status allocations can be found in Appendix 1 of this report (extracted from Montagu Evans' report and provided for convenience as an extract) which also considers the risks and opportunities around these sectors in further detail. However, the key point to note, is that although the property market on a macro level is in a 'recovery' phase, the sub-categories of supermarkets and industrial buildings are outperforming, and the sub-categories of shopping centres and high street retail units are particularly suffering.

3.6.6 The graph below illustrates the exposure that the portfolio has by sector.



3.6.7 Members will note in the next section that the Council's Investment Portfolio is heavily weighted in favour of High Street Retail, and therefore mitigating the risks and challenges this submarket is currently facing is a key objective of the Investment Strategy.

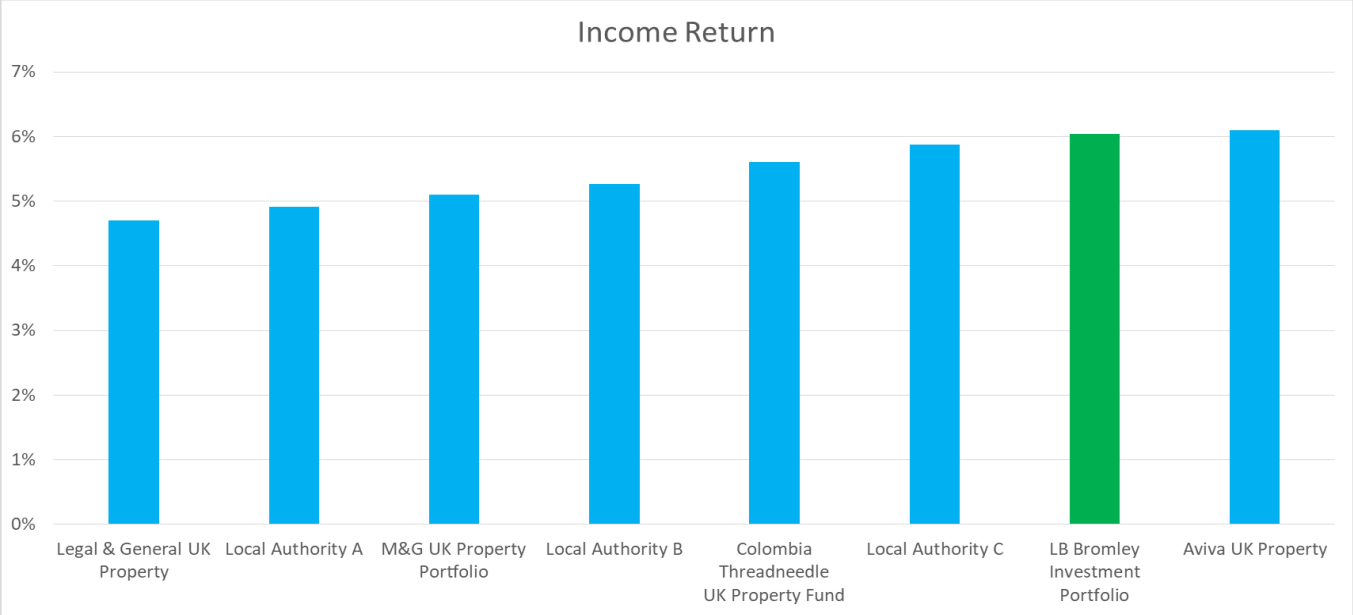
3.7 Portfolio Performance & Benchmarking

3.7.1 Income and capital value are related, albeit investors will have a greater focus on that which best aligns with their objectives. For councils, which are particularly seeking to provide resilient income to support services, it is important to understand those risks and potential exposure. It is not to say that capital values do carry less importance, but they can be impacted by external influences and sentiments that become more relevant when the capital value is crystallised at the point of sale.

3.7.2 Income returns are an important metric for many investors, whether they are institutional investors or Local Authorities. This is particularly so for the Council whereby the predominant objective for investing into commercial property is to generate an income stream as well as seeking to benefit from capital value increases to support the delivery of the Council's wider functions.

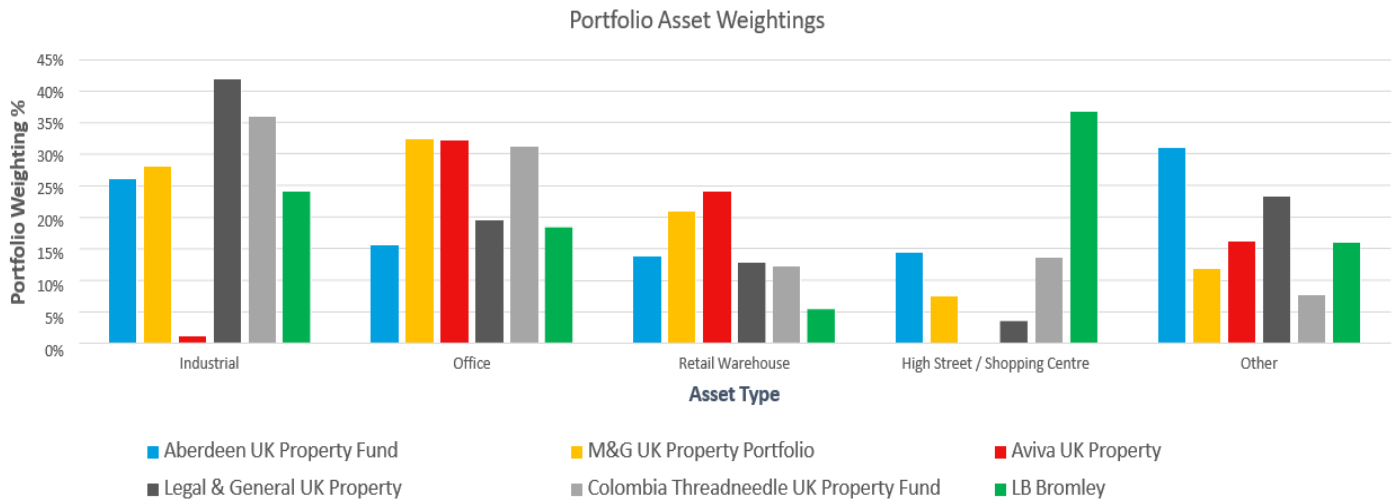
3.7.3 Some initial analysis has been provided to show how the Council's Investment Portfolio compares to the other institutional and Local Authority portfolios in terms of income return performance.

3.7.4 The graph illustrates that LB Bromley income return is broadly outperforming the majority of comparables which reflects the notion that the portfolio is in a healthy position.



3.7.5 Portfolio benchmarking is a useful comparator to assess how other portfolios across the market are weighted and their subsequent performance. Investigation has been undertaken into institutional portfolios and their weighting across sectors.

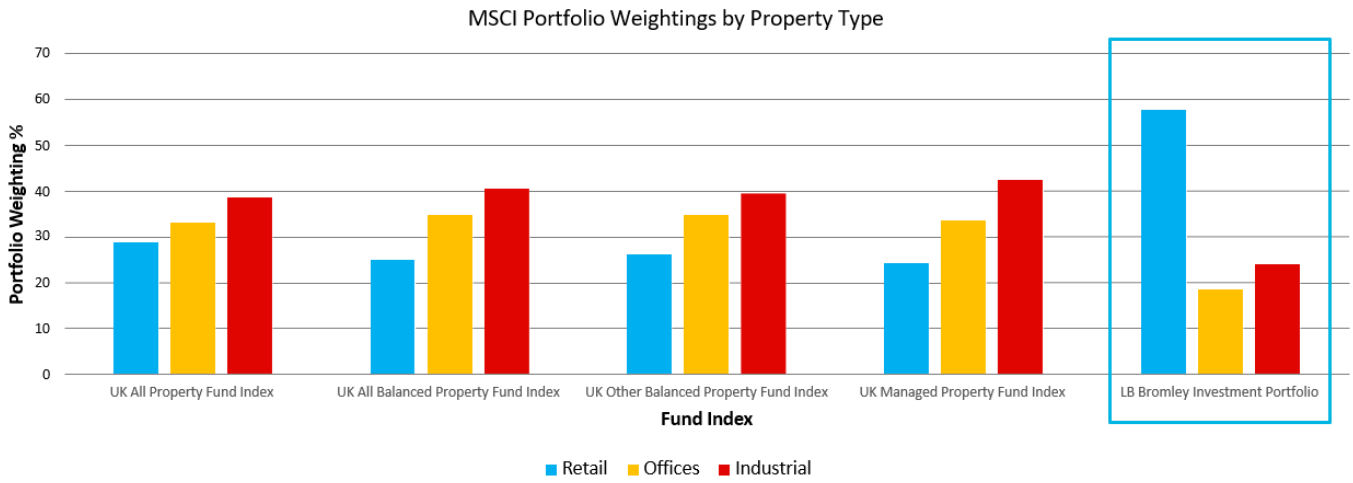
3.7.6 The graph below reflects the diversification of each specific portfolio. The LB Bromley Investment Portfolio has been benchmarked against those portfolios to provide a comparison in terms of its own portfolio diversification. The data illustrates that the LB Bromley Investment Portfolio is largely under-weighted across the Industrial, Office and Retail Warehouse sectors, however the Portfolio has a significantly higher weighting towards the High Street retail sector compared with the other institutional portfolios.



3.7.7 Although the Council's portfolio is performing very well compared to others, its risk profile is greater given its higher exposure to more challenging sub sectors such as high street retail, and its far lower exposure to some of the stronger performing sub sectors such as industrial and retail warehousing.

3.7.8 MSCI, formerly known as IPD, is the investment property industry standard set of benchmarks against which portfolio performance can be compared. The various Property Fund Indexes collect data from across property funds and amalgamate it into data sets to provide averages, comparison and return benchmarks. A number of indexes have been selected against which to benchmark the sector exposure of the assets in the portfolio against averages within each fund sub-type (All Property Funds, All Balanced Property Funds, Other Balanced Property Funds and Managed Property Funds).

3.7.9 The data shows that average funds are decreasing weighting in Retail in favour of increased exposure to Offices and Industrial. This indicates that the portfolio is overweight in the Retail sector and underweight in Offices and Industrial.



3.7.10 Analysis into institutional benchmarking has highlighted the fact that the portfolio is overweight in retail compared with average sector weightings across other indices. This is not particularly surprising as the majority of the assets in the portfolio were purchased between 2012 and 2016. Although structural changes within the retail sector were becoming apparent at that time, retail was regarded as a stable asset class with strong fundamentals. The rise of e-commerce and its long-term impact on the sector was not yet realised. In contrast, industrial was seen as the "poor child" of property and not deemed to be a trophy asset class.

3.7.11 Institutions, such as those captured by the MSCI dataset, will be set up in a way that allows them to be agile and to respond to fundamental market changes so that their investors aren't exposed.

3.7.12 Hence over the last 5 years, many institutional portfolios will have been repositioned. This repositioning has been well documented, with many retail assets being sold off. Unfortunately for many, that has been at a significant loss in terms of capital values. In turn industrial assets and have been acquired. As the graph illustrates, across all indices the funds have a higher weighting towards industrial. For Bromley, this is the second largest sector, with retail accounting for over 50% of the portfolio.

3.7.13 Overall, this analysis supports the rationale for repositioning the portfolio. Careful analysis will need to be undertaken to understand the loss that will be made if some of the retail assets are disposed. However, this shouldn't necessarily be a barrier to asset repositioning as the portfolio needs to perform over the long term even if a short term loss is crystalised.

3.8 Portfolio Performance Overview

3.8.1 The below snapshot provides an overview of the Council's property investment portfolio performance:

Key Portfolio Statistics

- **£59.805m Capital Value** – Although this has reduced on many assets, there are opportunities to redevelop and add value
- **5.27% Running Yield** – This is the running yield based on acquisition price and has reduced from 6.04% following Arcadia's administration
- **£4.713m Annual Income** – Performing robustly despite challenges in the retail market. Potential risk due to some assets being over-rented

3.8.2 In summary, the portfolio is meeting the base Investment Criteria as adopted in 2017.

3.8.3 As detailed earlier within this report, the composition of the portfolio is heavily weighted towards High Street Retail with less exposure to better performing sub markets than many similar investors. It is therefore important to note that although the investment portfolio is meeting the Council's investment criteria and performing comparatively well when bench marked against similar funds, an active and structured asset management plan is critical in ensuring optimal performance to best meet the Council's objectives.

3.9 Portfolio Performance v Income Alternative

3.9.1 The overarching reason that the Council acquired Investment Properties was to receive the benefit of rental income to fund the delivery of services. The objective of generating an alternative income stream for the Council could have been met by investing into Treasury Management (a LB Bromley specific option), or alternative income producing assets such as 10-year Treasury Bonds (a market alternative).

3.9.2 However, both alternative options would have provided considerably less return on investment than the property investments have done since their acquisition, despite challenging market conditions.

3.9.3 The graph below demonstrates that the rate of return achievable on 10-year Treasury Bonds from 2012 until Jan 2022. The rate of return has been declining from a high of c. 3.1% in 2013 to a low of 0.1% in July 2020, with the current rate at 1.18% (Jan 2022).

3.9.4 Treasury Management performs similarly to the above, with the average yield at 1%.

3.9.5 The assets within the Council's Investment Portfolio have been acquired between 2012 and 2017, with a running yield of 5.27% (6.04% prior to Arcadias administration), which compared to the potential return that could have been achieved in that period through investment into Treasury Management at 1%, clearly demonstrating the additional returns that the Council has benefitted from through its decision to investment in property than could have been achieved through an alternative investment into Treasury Management or Treasury Bonds.

3.9.6 Over the lifetime of the investment portfolio, the additional income to the Council over and above Treasury Management returns stands at circa £29m, calculated until the end of Dec 2021, and is set to continue to rise year on year based on current market forecasts.

3.10 Reviewing the Investment Strategy

3.10.1 The Council has a concise strategy and set of requirements for the Investment Portfolio. In summary, the strategy requires the key metrics outlined below:

a) Net investment return – 5% +

b) Diversification – Requirement is limited but points towards having a diversified portfolio

c) Liquidity – 1 year disposal window

d) Tenant Risk – Option to retain a degree of Landlord control, with aim of reducing exposure to tenants with Security of Tenure

e) Repair Liability – Reduce landlord exposure to repairing covenants

f) Capital Values – Investment into suitable locations, mitigating risk of a fall in capital values

g) Lot Size – In excess of £5m

3.10.2 The current strategy was last reviewed in 2017 and Executive approved the investment criteria above on 19th July 2017. Since then, market changes, asset specific issues and changes to the financial and regulatory landscape means that the time is right for a review of the strategy.

3.10.3 This will better enable the Council to actively manage the portfolio, reflect current demand and risk, and ensure that there is a plan that enables active reinvestment to ensure that revenue streams are maintained over the longer term.

3.11 Importance and Impact of Active Management

3.11.1 As with many other Councils, Bromley has predominately invested into commercial property for an income return as well as seeking to benefit from increases in capital values.

3.11.2 Property and economic cycles impact values and income and, as explored in sections 3 and 4, sub-market and asset specific risks impact the Portfolio at different times. Consequently, to ensure continued positive returns, the Portfolio needs to be actively managed: reviewing and taking profits where possible, to mitigate risk elsewhere and ensure long-term, robust income.

3.11.3 Whilst some of the assets in the investment portfolio are relatively dry, requiring low intensity asset management, others will need a more active approach. Hence, contrary to a more traditional asset management approach, which might entail a more passive approach and a fixed hold period, active asset management will include the constant monitoring and adjustment of the asset performance with respect to the overall investment strategy.

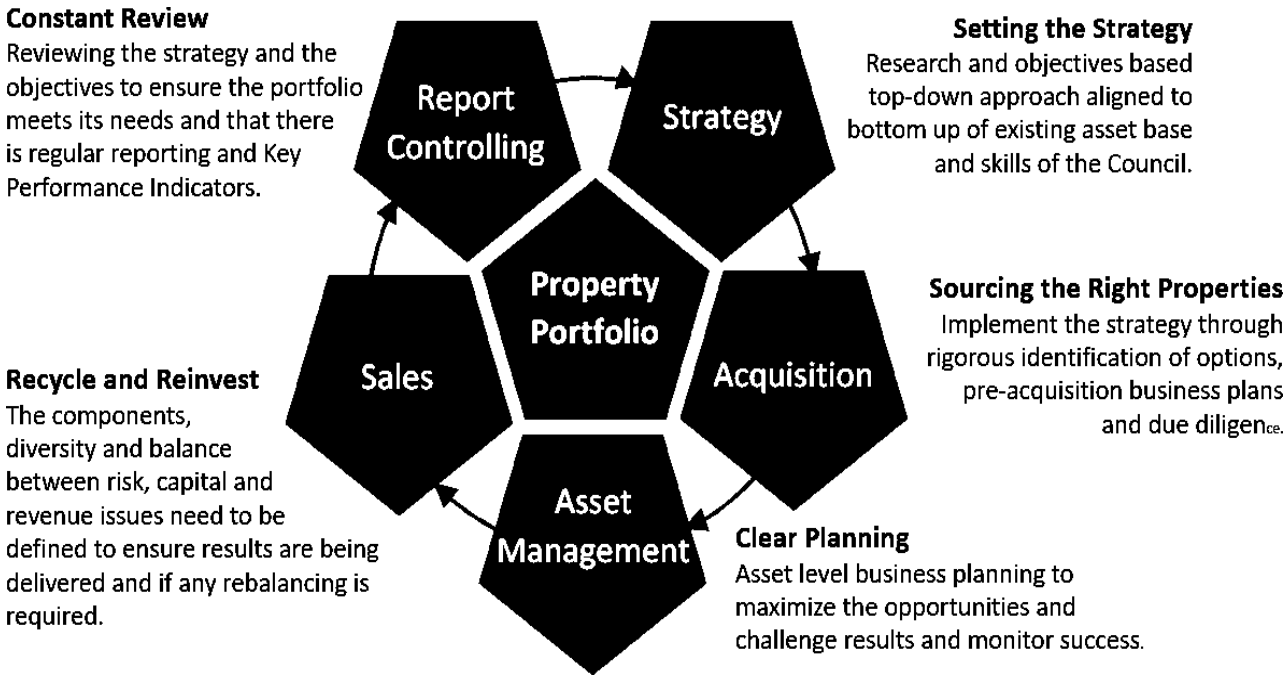
3.11.4 The active asset management will ensure that the income return generated from the portfolio is as stable as possible and has a suitable degree of longevity.

3.11.5 Income only provides part of the picture of portfolio management. It is likely that over a typical 5 – 10 year hold period the portfolio will incur various cost items to cover void periods, re-letting, interest, tenant defaults, scoping exercises for alternative uses and capital investment for repositioning and non-recoverable repairs and improvements.

3.11.6 However, in addition to a securing a net income position, margins can also be made on the increase in capital values, however this is typically dependent on the point in the real estate cycle at which the asset is disposed.

3.11.7 Income, capital values and costs contribute to determining the total Internal Rate of Return (IRR) for the asset and the portfolio. The IRR is defined as “the rate of return as a percentage that discounts the investment flows to a net present value of zero” This metric can be used to as a benchmark to assess the portfolio performance against other investment alternatives.

3.11.8 The flow diagram below highlights the overarching principles required to deliver a robust investment and asset management strategy to maximise returns.



3.12 Investment Strategy & Next Steps

3.12.1 The below list sets out the Council's revised Strategic Objectives as agreed by the Property Investment Board, which will guide recommendations as to appropriate KPIs and individual asset plans.

3.12.2 It should be noted that the below provides headlines only and the Strategic Objectives will come back to ERC PDS and to the Executive Committee for consideration with detailed individual asset plans to demonstrate how these objectives will be met in due course:

1. **Income to Exceed Treasury Management Alternative**

   - Ultimately the risk and effort must meaningfully exceed the alternative

2. **Recycle Capital into Less Risky Investments**

   - Reducing risk will reduce yield but better align with a cautious approach to securing income

3. **Maintain High Standards on Energy Efficiency**

   - Ensure compliance with rules and reflect the movement in the market towards environmentally better performing assets

4. **Ensure Forward Plan for Planned and Responsive Capital Investment**

   - Reinvestment will be required either for alternative uses for challenging assets or for improvements to tenant retention and attraction

5. **Install and Maintain Robust Governance**

   - Newly constituted Property Investment Advisory Board to oversee decisions with delegated authority from Executive and support from Property Services and Montagu Evans (or any other appointed professional advisors)

3.12.3 There are risks and opportunities in the Portfolio that can be mitigated and exploited respectively via active management, reinvestment and redeployment. Where assets are within the Borough, there may be additional local considerations around local economic growth, job creation or protection, land assembly and housing delivery, for example, in addition to traditional portfolio management performance metrics.

3.12.4 The Strategic Objectives are proposed to ensure that the Portfolio aligns with the Council's objectives and ensures best performance from the investments.

3.12.5 To measure the ongoing performance of the Portfolio against the strategy, a set of Key Performance Indicators are proposed under three key areas: Financial, Governance and Operational.

3.12.6 Together, they provide parameters for active management of the Portfolio and the ability to delegate authority to the Property Investment Advisory Board (as per the Executive decision in July 2020), to manage the Portfolio within the performance parameters adopted.

3.12.7 As the Councils appointed advisors progress through their agreed scope of works, Officers will bring a further paper relating to the Council's Investment Portfolio, with recommendations as to the KPIs and individual asset plans that should be adopted, to ensure optimum portfolio performance, for Member's consideration.

3.12.8 It is important to note that the Investment Strategy, KPIs by which the portfolio's performance is measured, and the individual asset plans, need to consider and reflect wider Council objectives and the ongoing Operational Property Review, and Officers are working closely with the Council's appointed advisors to ensure a holistic approach delivers an optimised strategy going forwards.

4 IMPACT ON VULNERABLE ADULTS AND CHILDREN

N/A

5 POLICY IMPLICATIONS

N/A

6 FINANCIAL IMPLICATIONS

6.1 The current annual income budget for the Investment Portfolio properties is £5.2m and monitoring during 2021/22 has been anticipating a similar outturn position, on the basis of the actual value of invoices issued.

6.2 However, as a result of ongoing market pressures and the impact of Covid on high streets, there is some uncertainty over the current outstanding debts of tenants within these properties, including amounts due from Arcadia who are now in administration. This accounts for the variation between the budget and latest updated rental values of £4.7m.

6.3 Whilst other tenants have received assistance in the form of rental deferments, ultimately it is likely that some will be unable to pay, and the Council has set aside additional provision for bad debts in anticipation of an increase in non-payment.

6.4 The cost of the specialist investment portfolio advice from Montagu Evans is £118k over the four-year life of the contract. In Property Services officers' opinion, appointment of a strategic advisor reduces the risks of a detrimental impact on the revenue generation opportunities that can be achieved from the portfolio, and therefore funding of the contract costs is offset against investment income.

Non-Applicable Sections:	Impact on Vulnerable Adults & Children, Policy Implications Personnel Implications, Legal, Procurement Implications
Background Documents: (Access via Contact Officer)	

Appendix 1 – Property Market
Sub-sectors Overview

SUB MARKET REVIEW

A market summary of each sub-sector has been provided. The market context provides a rationale to the challenges that some assets are facing and will ultimately inform the strategic direction of the portfolio.

A RAG rating has been assigned to each of the sub-markets, giving a high level overview of how that particular market is preforming. The RAG ratings are applied according to general sentiment within the current market.

Market Sentiment RAG

	Relatively volatile market illustrating declining rents, increasing yields and structural changes impacting the financial stability of tenants. Opportunities for value-add and redevelopment, but with higher risk.
	Market is going through a period of change and there is a degree of instability across the sector. Rents and values are relatively stable although the medium to longer term horizon is less certain.
	Relatively stable sector with buoyant rents, values and an active investment market. Lower risk and opportunities to profit take.

HIGH STREET RETAIL

General Sentiment

It has been well documented that the High Street sector has been one of the hardest hit retail sub-sectors during the course of the pandemic. As many retailers on the high street were not able to trade during the mandatory national lockdowns their revenues have dramatically decreased.

For those retailers that had not invested in their online platforms, or who were slow to respond to the changing consumer patterns, the effects of the pandemic have exacerbated the challenges that they were already facing. Even the biggest of brands, such as the Arcadia Group, were not “too big to fail”.

Over the last 18 months, this sector has been heavily supported by the government and, across the market, retailers have called upon Landlords for additional support. The degree of support has varied, with measures including monthly rental payments instead of quarterly rents, rents deferrals in lieu of increased lease terms, write off of rental payments with many of the bigger landlords sharing the burden 50:50 with the retailer.

Going forward, some of these supporting measures will reverse to Business As Usual (BAU), however some of these changes are likely to remain and become the norm. For example, retailers that are considering lease renewals and re-gears will seek to pay monthly rather than quarterly in advance. Others are negotiating ‘pandemic clauses’ which often include pre-agreed rent deferment or rent abatement terms within this clause.

RETAIL WAREHOUSING

General Sentiment

The retail warehousing market has, on the whole, proven to be relatively resilient during the course of the pandemic. The nature of these assets gives rise to additional click & collect services with larger store formats and car parking provisions enabling both the retailer and the customers to benefit from this additional service particularly during the national lockdowns.

During 2020, discount retailers such as B&M, Home Bargains, Aldi and Lidl were particularly acquisitive in this sector. Other retailers such as DIY and home improvement retailers have also proven to be particularly successful as uncertainty in the residential and job markets have led to home-owners undertaking home improvements rather than buying and selling their properties.

Despite this positivity, retail warehouse assets with occupiers of fashion focused businesses have proven to be less resilient as reduced trading hours during the national lockdowns in conjunction with the fundamental changes that are occurring in the fast-fashion sector have negatively impacted their retailers and the assets that they occupy.

The risks associated with the retail warehousing sector can in part be mitigated by alternative uses. The assets are relatively flexible, lending themselves to logistic distribution centres as they are typically located in out of town locations. Due to their peripheral locations, they can also support redevelopment for housing. Hence, this asset class benefits from a degree of flexibility which helps underpin its investment value.

SUPERMARKETS

General Sentiment

Within a troubled retail sector, the supermarket sub-market performed well in comparison to high street retail, shopping centres and out-of-town retail. The pandemic created unprecedented sales volumes for the sector both in-store and online with lockdowns prompting a return to the weekly 'Big Shop'.

Whilst those retailers that were able to keep their stores open have profited, the occupier market is expected to see rental decline. Supermarket rents are forecasted to fall by 3.5% in 2021, though this is a relatively lower decline than other retail asset types.

The investment market has seen a strong increase in appetite with £1.82 billion of transactions in 2020, an increase on £1.78 billion in 2019. Supermarkets will outperform other asset types over the next five years, driven by increased sales and store expansions. Capital values are forecast to increase by 1% (5-year annualised) and total returns averaging around 6% (5-year annualised).

SHOPPING CENTRES

General Sentiment

Akin to the High Street sub-market, the shopping centre sub-market has been hit equally as hard by persistent lockdowns, changing consumer sentiment, a tumultuous sector of CVAs, income uncertainty, over renting and over valuation.

With 2020 representing the worst year on record with sales volumes of only £300 million, 2021 has seen a more robust start to the year with 22 deals either exchanged or under offer at c. £450million agreed or completed. Purchasers are more encouraged that there is a discernible affordable (albeit much reduced) rental tone and valuations are beginning to reflect the risks that purchasers are taking.

The UK is currently experiencing a number of overseas investors enter the market, however this is far from a strong market. Purchasers are nervous although it helps significantly if there are alternative uses, or development opportunities, particularly in larger towns where community uses are an attractive alternative to retail.

The outlook for 2021 and the sector as an investment sub-sector remains extremely uncertain unless the business plan is part of a major town centre regeneration piece.

OFFICES

General Sentiment

During the pandemic and particularly during the first of the national lockdowns there was much speculation over the longevity of the office markets. Many businesses, both large and small, quickly adapted to working from home.

Surveys that were released in the summer of 2020 provided much pessimism as many office occupiers were reporting that working from home 5 days a week would be the norm for the majority of their workforce. As expected, this sentiment was reflected in both the occupier and investment market as acquisitions and relocations were put on hold by occupiers, and investment was recorded at one of the lowest levels.

As the pandemic has progressed, those initial knee-jerk reactions have somewhat mellowed. More recent surveys have highlighted that a greater level of importance is being put back on office environment. A degree of equilibrium has been restored with many citing that offices are important for those activities that require collaboration and social interaction whilst work tasks can be undertaken at home.

Despite remote working reducing utilisation rates, a historic focus on these rates and the densification of space has already driven efficiencies and resulted in limited excess space in optimised portfolios. Importantly it is anticipated that the additional area required for collaboration space will offset any further loss through lower utilisation rates.

This sector is still going through a period of stabilisation as occupiers are beginning to return to the office. More time is required to assess whether the workforce returns to the office 5 days a week or whether a balance will be sought between office and remote working. If this balance is sought, it will be interesting to understand how density rates change or if they will continue to remain at c.8m^2 per person.

INDUSTRIAL

General Sentiment

The industrial market out-performed all sectors over the course of 2020 and produced record breaking results. This trend has continued in H1 2021.

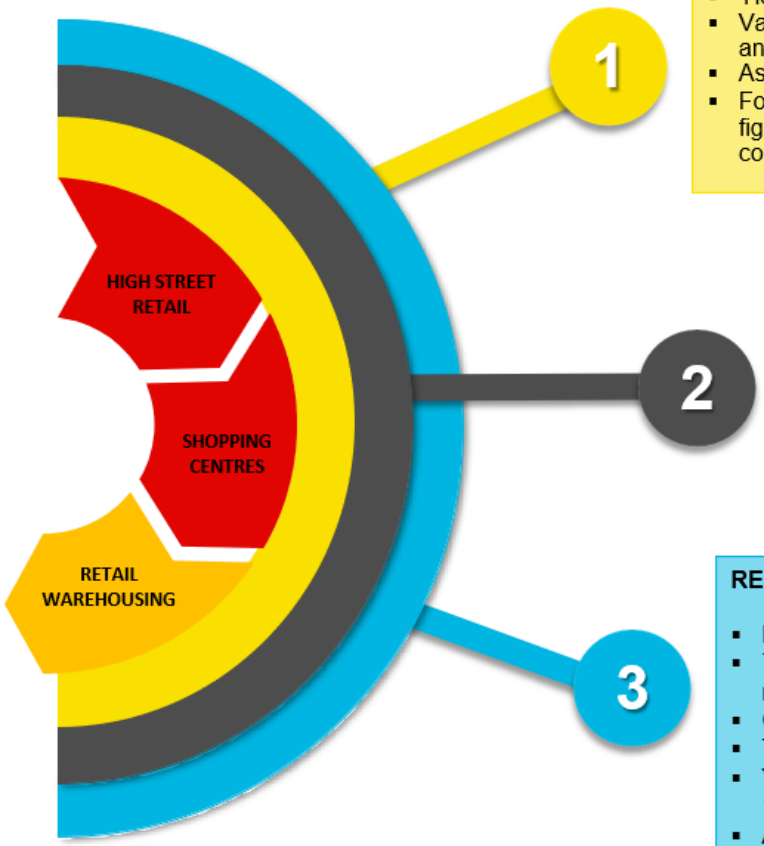
The performance of the industrial market is underpinned by strong property fundamentals. Supply is averaging 1.5 years take up (based on take up volumes in 2020) and demand is increasing particularly as the switch to online shopping increases. From an investment perspective investor appetite is strong with many investors rebalancing their portfolios with industrial assets.

As a consequence, rents are still on the rise and prices have reached new records. The Pandemic has highlighted the flight to quality and whilst some commentators have called the peak of the industrial market, others are recognising the continued importance of this sector and are predicting the trends seen in H1 2021 to continue.

This sector is a robust asset class, and performance is likely to continue, although there will reach a point where yields cannot compress further and a peak in values will be reached.

MARKET SENTIMENT SUMMARY TABLE

RAG SUMMARY		
	High Street Retail	
	Retail Warehousing	
	Supermarkets	
	Shopping Centres	
	Offices	
	Industrial	



HIGH STREET RETAIL

- Yields increased by 75 basis points (bps) (0.75%) during 2020.
- Values had stabilised towards the end of 2020 however, with the 3rd national lockdown, yields shifted outwards again and rose by a further 25 bps over Q1 2021.
- As at August 2021, average High Street retail yields for good secondary locations range between 8.25%-8.50%.
- Footfall figures are still in a state of fluctuation. As of 21st August 2021, footfall in the week declined by -2.2%. These figures reflect a -26.3% decline over the same time period in August 2019. This illustrates a much slower recovery compared with the retail park sector.

SHOPPING CENTRES

- 12 of the 22 transactions within 2020 were acquired by local authorities. Only 6 were traditional commercial purchasers.
- Top deal - Touchwood Solihull, exchanged by Lend Lease RP to Ardent Capital for £90million / 9.50%.
- Sub-regional yields have continued to soften to around 9.00% in Q1 2021 and have since stabilised at that level.
- Yields for local schemes now range at between 10% - 15% depending on their degree of success. Those that are deemed more successful have stablised in terms of their pricing

RETAIL WAREHOUSING

- H1 2020 B&Q online sales rose 164% year on year to 19% of total sales.
- 79% of those online sales were for click & collect, illustrating the importance of bricks and mortar for this particular retailer.
- Covid resilient retail parks comprise tenants who have been able to remain trading.
- There has been increasing investor sentiment towards retailers in home furnishing, toys and electrical sub-sectors.
- Yields for solus bulky goods (15 year income) have decreased by 75 bps since March 2021 to 5.75%, reflecting a 100 bps over the last year since August 2020.
- As of 21st August 2021, weekly footfall figures are lower than 2019, but only marginally by -2.9% and is a far smaller decline compared with other retail asset classes illustrating the resilience of this sub-sector.

SUPERMARKETS

- Supermarket prime yields have compressed further in the last quarter from 4.50% to 4.25%
- RPI linked income has seen a tightening of prime yields to 3.50%, albeit these values have now stablised.
- Owner-occupiers accounted for 11.7% of total investment volumes throughout 2020.

INDUSTRIAL

- Take up hit 59.7 million sq ft in 2020, 20% higher than previous record set in 2016
- Rental values increased by 1.4% during Q1 2021
- Total returns for Q1 2021 totalled 5.8%
- Capital growth totalled 4.6% in Q1 2021
- Prime yields are now averaging 3.25%
- Industrial assets outside of prime locations have also seen yield compress further over the last quarter and as of August 2021, these yields range from 5.50%-4.50% depending on location and stability of income.

OFFICES

- Anticipated that Covid will amplify the importance of wellness. Business parks do have a number of benefits that can support such requirements.
- SE Business Parks (Multi-let, 5 year WAULT) yields at 6.75% a 50 bps increase since January 2021.
- UK office take up in Q1 2021 totaled 2.0 million sq ft remaining below the 5-year quarterly average of 3.6m sq ft.
- Regional take up totaled 670,00 sq ft, the lowest since Q2 2020.
- Vacancy rate in the Big Seven office markets at 7.6% in Q1 2021.