

**Current Fund Summary – 2019/20**

**OBJECTIVE OF FUND**

The Investment Property Fund aims to provide a high and secure level of income with the prospect of income growth, and to maintain the capital value of the properties held in the Fund. This is achieved by working to keep vacancies and associated costs to a minimum and by generating income growth through rental increases, refurbishments, active asset management and new lettings, as well as investing in a diversified commercial property portfolio.

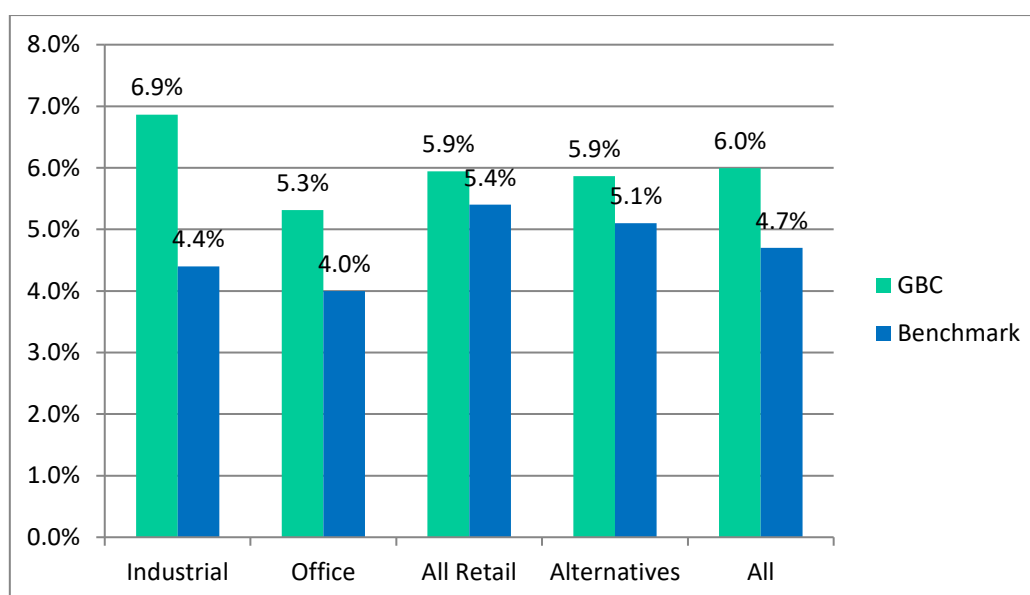
**KEY POINTS – 31 MARCH 2020**

- Fund size c.£152 million.
- Rental income of over £8.1 million pa.
- 156 properties over 4 main sectors
- High yielding (6% net of costs/voids)
- Low vacancy rate (3.29%)
- Long average unexpired lease terms

**TOP SIX SINGLE INVESTMENTS**

- Wey House, Farnham Rd
- Friary Centre
- The Billings, Walnut Tree Clse
- 10 Midleton Industrial Estate
- Friary Street, West Side
- Moorfield Point, 41 Moorfield Rd

**FUND PERFORMANCE AGAINST UK BENCHMARK 2018/19**



**KEY ACQUISITIONS AND DISPOSALS 2018/19**

Property	Interest	Price paid	Date of completion	Previous rent pa	Estimated rent pa
<b>ACQUISITIONS</b>					
1 & 2 Thornberry Way, Slyfield	Leasehold (to merge Freehold)	£6,550,000	04/12/2018	£51,570	£590,000
<b>DISPOSALS</b>					
Liongate, Ladymead	Freehold	£10,170,000	06/03/2020	£ 980,000	N/A

**Property Investment Fund – 2019/20**

**FUND STRATEGY**

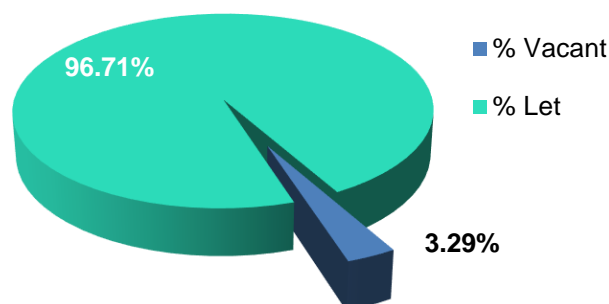
The Fund comprises the principal commercial property sectors: office, retail, industrial and alternatives (hotels, car showrooms, petrol stations, leisure, etc.).

Officers aim to achieve an above average income return by keeping vacancies and associated costs (such as empty rates, service charges, repairs and insurance) to a minimum and by generating income growth through rental increases, refurbishments, active asset management and new lettings. The vacancy rate is currently 3.29% (excluding intentional voids).

**VACANCY RATE**

Based on days per property

Qtr 1	Qtr 2	Qtr 3	Qtr 4	Year
1.39%	2.07%	4.57%	5.11%	3.29%



**PERFORMANCE**

The fund currently stands at just over £152 million with a total rent roll of over £8.1 million per annum. This represents a total net return of 6.0%. This is down from last year for a number of reasons:

- Disposals and Acquisitions - Liongate House was sold in March 2020 for £10.17m (£980,000pa). This was partially offset by the purchase of Thornberry Way in August 2019 for £6.55m. These transactions helped to reduce the fund's exposure to office stock whilst increasing industrial holdings.
- Revaluation of High Street Assets - whilst a number of industrial assets experienced large increases in value, there was a shift away from High Street retail (pre COVID-19) leading to declining rents and increased vacancy levels. This led to a number of the asset having to be re-valued. However, due to the rent review patterns, rental income for Council owned shops remained unaffected in 2019/20.
- Midleton Redevelopment – As units were vacated ready for demolition rental income was affected (rental loss of c.£210,000pa). Some units were also temporarily de-valued as a result. Officers have tried to mitigate the impact of the redevelopment where possible by keeping tenants in the units until they are required for demotion and temporarily re-letting properties after demolition (for example, the cleared sites at 3 & 4 Midleton have been let for external storage generating £10,500pa).

<b>Fund Performance (total return) *</b>					
<b><u>Rental income</u></b>					
	<b>Industrial</b>	<b>Office</b>	<b>All Retail</b>	<b>Alternatives</b>	<b>All</b>
2015/16	2,679,571	1,831,900	1,750,254	885,636	7,147,361
2016/17	3,057,302	1,858,638	1,447,672	1,062,137	7,425,749
2017/18	3,493,405	3,186,048	1,426,317	1,080,786	9,186,556
2018/19	3,619,808	3,038,548	1,459,048	1,129,361	9,246,765
2019/20	3,369,452	2,135,460	1,459,548	1,139,397	8,103,857
<b><u>Capital value</u></b>					
	<b>Industrial</b>	<b>Office</b>	<b>All Retail</b>	<b>Alternatives</b>	<b>All</b>
2015/16	39,077,755	19,227,500	34,270,000	11,233,500	103,808,755
2016/17	42,922,450	25,915,000	25,908,500	15,963,500	110,709,450
2017/18	51,509,000	49,574,000	26,065,000	17,471,500	144,619,500
2018/19	66,970,000	49,159,000	26,097,000	18,843,000	161,069,000
2019/20	72,295,790	35,609,000	26,097,000	18,143,000	152,144,790
<b><u>Income return</u></b>					
	<b>Industrial</b>	<b>Office</b>	<b>All Retail</b>	<b>Alternatives</b>	<b>All</b>
2015/16	8.0%	7.5%	5.6%	7.5%	6.8%
2016/17	7.1%	7.2%	5.6%	6.7%	6.7%
2017/18	8.0%	7.4%	5.2%	5.8%	6.6%
2018/19	6.8%	6.6%	5.9%	5.8%	6.3%
2019/20	6.9%	5.3%	5.9%	5.9%	6.0%
<b><u>Benchmark return</u></b>					
	<b>Industrial</b>	<b>Office</b>	<b>All Retail</b>	<b>Alternatives</b>	<b>All</b>
2015/16	6.1%	4.7%	5.4%	4.7%	5.2%
2016/17	5.4%	4.1%	5.0%	5.5%	4.8%
2017/18	4.9%	4.1%	5.1%	5.3%	4.8%
2018/19	4.4%	4.0%	5.1%	5.0%	4.6%
2019/20	4.4%	4.0%	5.4%	5.1%	4.7%

\* Excludes Finance leases

- Other Voids – Tenant liquidations have led to voids including two floors at 2 The Billings, and 1 North Moors (now under offer). Other voids included: 10 Midleton (now under offer); Thornberry Way (the Hub is also under offer); 23 Woodbridge Meadows (agreement for lease in place); and Castle St 40A (moth balled for disposal - awaiting Museum review).
- Reclassification of Assets to the Operational Portfolio – Some assets have been transferred to the Operational portfolio. This represents a total loss in value of £1,220,000 (£96,325pa in rent).
- Weyside Urban Village - the loss of units on Slyfield Industrial Estate to enable site assembly for the Weyside Urban Village. This represents a total loss in value of c.£500,000 (and just under £100,000pa in rent).

- COVID-19 - The Coronavirus epidemic did touch the end of the 2019/20 and delayed a number of lettings but, on the whole, 2019/20 preceded the deepening of the situation and the subsequent declaration of a Global Pandemic.

Whilst the value and income of the/ portfolio has reduced this year as a result of the above, due to mitigating income generation through rent reviews, new lettings and active asset management the fund continues to perform well and significantly above benchmark.

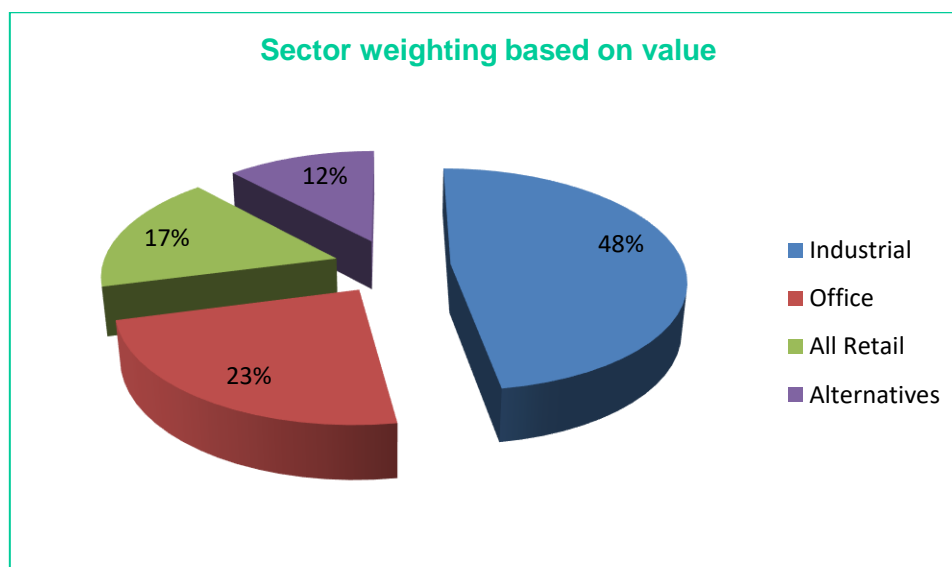
**KEY TRANSACTIONS**

Property	Transaction	Previous rent pa	New rent pa	Comment
Stonebridge Depot, Shalford	New 10-year lease	£131,450	£222,000	Uplift of 69%
12 Midleton Industrial Estate	Rent review	£80,000	£115,000	Uplift of 44%
3 The Billings, Walnut Tree Close	New 10-year lease		£154,424	After long void period

Currently the investment fund has a high weighting of industrial investments in comparison to and office, retail and alternatives. This is higher than last year due to the acquisition of 1 & 2 Thornberry Way (increasing industrial exposure from 42% to 48%) and disposal of Liongate House (reducing office exposure from 30% to 23%).

Industrial was the strongest sector going into lockdown and the sector expected to hold up best 2020/21. Although, smaller/older units linked to manufacturing or public facing may have slightly decreased value due to increased risks around tenant liquidity, voids and rental values going forwards.

Alternatives performed well in 2019/20 there may be temporary valuation falls to reflect increased risk around these asset types in the light of COVID-19. However, this should not be significant in % terms and should not affect the strategy for the fund.



Overall, the make-up of the portfolio as detailed above is considered to mitigate against significant value and income falls.

The Council's ability to source the right investment stock at the right price continues to be the biggest driver of performance.

### **KEY ACQUISITIONS AND DISPOSALS 2019/20**



#### **Llongate House, Ladymead**

Llongate is a 43,000 sq.ft late 1980s office building situated on Ladymead. The tenant actioned a tenant only break clause in September 2019. Whilst in a prominent position alongside the A3 and Ladymead at the Stoke intersection, the location is not very convenient for office-based staff as there is virtually no local amenity

and it is not well positioned for public transport, being more than one mile from Guildford mainline station.

The Property is over thirty years old and would require substantial investment to be capable of new occupation. In addition, the Guildford Office market is going through a structural change in terms of relocation and shrinkage of some of the mature corporates. Demand is now for smaller space, good quality Grade A offices, centrally located. To complicate matters, the majority of the site is currently designated Environment Agency Flood Zone 3b.

Given the lack of demand for large offices and the issues around planning it was decided to market the site. The property was sold in March 2020 for £10,170,000.



#### **The Hub, 1 Thornberry Way & The Rock, 2 Thornberry Way**

The Council owned the freehold of these modern industrial warehouses. In August 2019, the Council acquired the leasehold for £6,550,000.

This is a key strategic acquisition in terms of location on the Slyfield Industrial Estate. The Council's freehold interest was valued by VOA earlier this year at £1,205,000. The Council's interest after acquisition has been valued by independent valuers, Avison Young, at £8,450,000. This valuation explicitly allowed for a marketing void for each unit, assumed rent free, and capital expenditure for refurbishment.

The Hub is currently being refurbished and is under offer. Works to refurbish the Rock are due to start shortly.

#### **Asset Investment Fund 2020-23**

A new Asset Investment Fund of £40 million was approved by the Executive in January 2020 as part of the Capital and Investment Strategy 2020-21 to 2024-2025. However, the Asset Investment Strategy which was due to go to the Executive in March 2020 has been put on hold pending the outcome of COVID-19.

## **CURRENT PROJECTS**

### **Midleton Industrial Estate Redevelopment**

The Council is currently undertaking a phased redevelopment of Midleton Industrial Estate.



**Phase 1** - Development of a pair of new semi-detached industrial units (c.5,000 sq.ft. each) with offices, has been progressing in spite of Covid-19. The current projected completion date is now the July 2020; one unit is already under offer.

**Phase 2/3** - Development of 15 new units (850-6,000 sq.ft.) following demolition of plots 12 - 15. Demolition works are well underway and construction works have been tendered. It is anticipated that work will follow on immediately from completion of the demolition works. Indicative programmes suggest that the construction work could be complete by summer 2021.



**Phase 4** - Design work for 20 small units (650 -800 sq. ft.) and demolition of plots 3-5 (completed) and 9 is well underway and a planning application will be submitted shortly. Work will then commence on detailed design and preparation of documents to issue to tender.

## **LOCAL PROPERTY MARKET 2019/20 REVIEW**

### **Industrial**

The industrial sector remained resilient in the first half of 2019/20 with tenant demand for space continuing to rise steadily.

The Guildford occupational market experienced rental growth characterised by a significant reduction in the availability of existing stock, limited new build and strong levels of take up. This has been fuelled considerably by the growth in internet retailing, online sales and customer fulfilment.

Industrial stock in Guildford Borough is made up of a number of industrial estates. Slyfield Industrial Estate is the main industrial estate (the biggest and arguably best located) within Guildford and comprises a mix of units in terms of size, configuration and uses. In the town centre, pressures on industrial land from higher value uses are adding to the supply constraints, pushing rents upwards and delivering real rental growth.

### **Office**

Whilst available office supply in Guildford has been declining, the departure of key corporate occupiers (Ericsson, Honeywell UOP and Sanofi) from the town has not helped the local office market.

Total availability (which includes new build/refurbishment schemes now on site) was 380,514 sq.ft. at end of Q4 2019 compared to total availability of 432,000 sq.ft. at end Q4 2018.

The market is reliant on the SME's for take up and demand is generally for smaller space areas of 3,000 -10,000 sq ft. It will take a number of these to fill the vacancy left by the larger corporates.

In 2019, the office market take-up in Guildford totalled 127,000 sq.ft. (the ten-year average annual take-up in Guildford is just over 90,000 sq.ft.). The town centre accounted for 53% of the take up by floor space and 50 % of the floor space by number of deals. Additionally, 80% of take up was of Grade A space.

The computer games sector continues to go from strength to strength. As an example, Wargaming have been experiencing stellar growth with their floor space increasing from circa 3,000 sq. ft. in early 2019 to 25,000 sq. ft. now.

### **Retail**

There has been a shift in the demand for High Street retail premises; this has led to declining rents and increased vacancy levels. In 2018 rents were being agreed at just over £300psf ITZA, this has changed significantly over the last few years and has led to a reduction close to £200psf ITZA in 2019/20 which is set to reduce further in 2020/21.

Retail property was undoubtedly affected by uncertainty over Brexit, however the more significant driver of falling values and transactional volumes was the structural challenges around online and omni-channel retailing. This was the weakest category going into Lockdown and is anticipated to be one of the worst affected, with negative trends exacerbated.

Retail warehousing is arguably the most defensive part of UK retailing against the rise of online retail sales. Despite the negative sentiment surrounding the sector, there continues to be significant occupational activity particularly at the value end of the market (Aldi, Lidl, B&M, The Range, Home Bargains).

### **LOCAL PROPERTY MARKET – OUTLOOK**

The impact of Covid-19 will be the main driver of economic performance in the near term. Despite the monetary economic, and fiscal measures that have been put in place to combat the economic fallout of the virus, it is strongly anticipated that the UK will enter a deep recession in 2020 which will exceed that observed in 2008-09 and indeed may surpass other historical crises. Among economists, there is a wide disparity on the case for the strength and speed of economic rebound<sup>1</sup>.

While property markets generally behave in similar ways during recessions (with tenant demand reducing, subletting rising, vacancy rates rising and ultimately rents falling), it is felt that consumer behaviour will shape the angle of the recovery and understanding how and where the economy will recover first, whether it be through a rise in precautionary saving or paying down debts (as non-essential spending has meant disposable incomes), a surge in spending on treats or in driving structural change<sup>2</sup>.

The other major moving part in the UK's recovery is Brexit. The already tight timeline set out for trade negotiations will be stretched further and there remains a high level of uncertainty surrounding UK's future relationship with EU.

Rents across the industrial sector meanwhile are expected to prove more resilient<sup>3</sup> with prime rents still expected to rise marginally according to the Q1 results in full.

In the office market there's a lot of debate over whether societies way of working has now changed forever. This will depend on whether workers and employers are more worried about presenteeism and job security in a time of rising unemployment rather than social distancing and downsizing.

Investors are certainly applying a "wait-and-see" approach.

# GBC INVESTMENT PROPERTY FUND PORTFOLIO ANNUAL REPORT

2019/20

<sup>1</sup> Avison Young: Economic and Property Market Review

<sup>2</sup> Savills: Looking ahead to the shape of the UK's recovery post-Covid-19

<sup>3</sup> RICS Q1 2020: UK Commercial Property Market Survey