GBC INVESTMENT PROPERTY FUND PORTFOLIO ANNUAL REPORT

2020/21

Current Fund Summary – 2020/21

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 keeping vacancy 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.

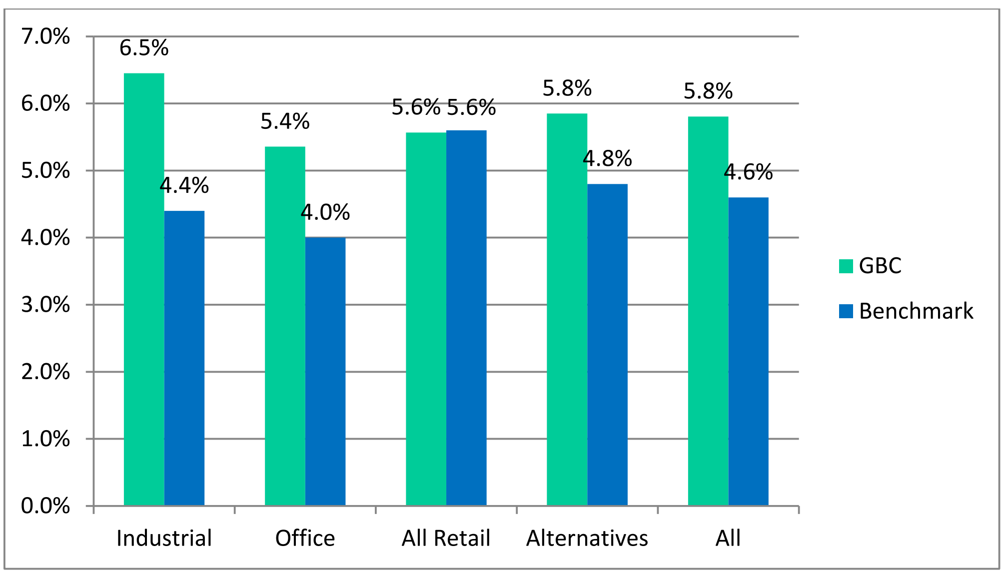
KEY POINTS – 31 MARCH 2021

- Fund size c.£155 million.
- Rental income of £8.1 million pa.
- 168 properties over the 4 main sectors
- High yielding (5.8% net of costs/voids)
- Low vacancy rate (5.76%)
- Long average unexpired lease terms

TOP FIVE SINGLE INVESTMENTS

1. Wey House, Farnham Rd
2. The Billings, Walnut Tree Clse
3. Moorfield Point, Slyfield
4. Friary Street, West Side
5. Friary Centre

FUND PERFORMANCE AGAINST UK BENCHMARK 2020/21



KEY ACQUSITIONS/DISPOSALS 2020/21

1 Midleton Industrial Estate
Acquired in September 2020 for £500,000 this prominent motor trade property with frontage to the A25 Woodbridge Road, is the gateway to Midleton Industrial Estate and will allow GBC to erect signage up for the new development. Currently let on a short-term lease, representing a GIY of over 8% whilst planning redevelopment.

Aldershot Rd 121B (The Co-Op) (HRA account)
Long lease to Co-operative Group at £200pa, sold in August 2020 for £250,000 with a restrictive covenant requiring the provision a food retail store on the site with a net sales area of not less than 3,000 sq.ft.

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Property Investment Fund – 2020/21

FUND STRATEGY

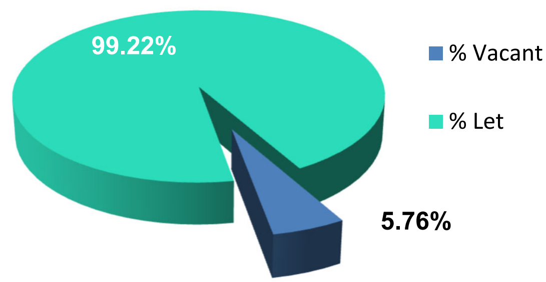
The Fund comprises the principal commercial property sectors: office, retail, industrial and alternatives (hotels, car showrooms, petrol stations, leisure, etc.).

Officers aim to achieve an above average income return by keeping vacancy 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 5.76%[1].

VACANCY RATE

Based on days per property

Qtr 1	Qtr 2	Qtr 3	Qtr 4	Year
5.34%	7.02%	5.93%	4.70%	5.76%



PERFORMANCE

The fund was valued at c.£155 million at the beginning of 2020. This is up from last year by over £2.7million mainly due to the increase in industrial values across the portfolio and the acquisition of 1 Midleton (Fox's). Rental held level with a total rent roll of £8.1 million per annum, representing a total net return of 5.8%.

Factors that affected the portfolio in 2020/21 include:

- **COVID-19** – The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a "Global Pandemic" on 11 March 2020, led to national and international lockdowns and impacted global financial markets. Market activity was impacted in many sectors. Despite this the impact on overall performance of the portfolio was minimal for several reasons. The Council's asset valuation date preceded the deepening of the Coronavirus epidemic and therefore only had a small impact on asset values. However, the Council's Valuers did report that given the unprecedented events it was felt that future impact that COVID-19 might have on the real estate market was unknown. The valuations were therefore reported on the basis of 'material valuation uncertainty'. Consequently, less certainty, and a higher degree of caution, should be attached to the valuation than would normally be the case.

  In terms of income, in general only rent deferments were granted[2]. In exceptional cases, for the worst affected commercial tenants, rent concessions were agreed but many of these have yet to be documented and, as such, did not affect the bottom line for 2020/21. Officers are taking steps to ensure that any knock-on effect in 2021/22 is minimised.

[1] Excluding intentional voids and Finance leases.
[2] As this report is based on a high-level snapshot view of performance rent deferments don't affect the bottom-line.

Fund Performance (total return) *

Rental income

	Industrial	Office	All Retail	Alternatives	All
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
2020/21	3,565,449	2,112,620	1,284,638	1,139,397	8,102,104

Capital value**

	Industrial	Office	All Retail	Alternatives	All
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
2020/21	77,670,905	34,165,000	24,527,000	18,540,500	154,903,405

Income return

	Industrial	Office	All Retail	Alternatives	All
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%
2020/21	6.5%	5.4%	5.6%	5.8%	5.8%

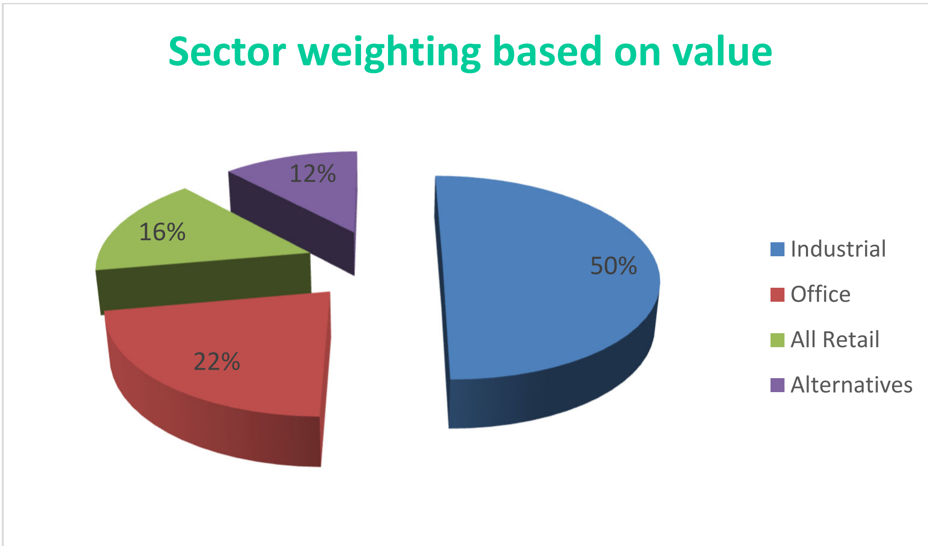
Benchmark return

	Industrial	Office	All Retail	Alternatives	All
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%
2020/21	4.4%	4.0%	5.6%	4.8%	4.6%

* Excludes Finance leases
**Capital Values as at 31/01/2020

- **Sector Weighting** – Industrial was the strongest sector going into the lockdown and the sector expected to hold up best. Officers have worked hard over the years to ensure that the investment fund has a high weighting of industrial investments in comparison to and office retail and alternatives. This helped to mitigate the effect of the pandemic with industrial values increasing, enabling the portfolio as a whole to not only hold its value, but increase despite the fall in value on other sectors. Due to the increase in value, the weighting of industrial now represents 50% of the portfolio.

- **Midleton Redevelopment** – Whilst the increased demand for industrial property and lack of supply led to an increase in value for the Council's industrial assets across the board, sites required for the Midleton redevelopment were temporarily de-valued as they were vacated and demolished to make way for developments. This also affected income; whilst some rent was collected for units in 2020/21 at the time of this snapshot report rent was recorded as nil return.



- **Revaluation of High Street Assets** – The shift away from High Street retailing was accelerated in 2020/21 due to COVID-19 lockdowns resulting in rents declining further and vacancy levels increasing in the market. This led to some of the assets having to be marginally de-valued. However, longer leaseholds with secure income retained their value. Income was affected on the High Street assets but elsewhere the Council managed to produce small uplifts in rent.

- **Rent reviews** – Several rents that were due for review during the pandemic were put on hold to assist tenants during this unprecedented time. These will be reviewed in 2021/22.

- **Voids/Lettings** – A number of properties that became void in 2019/20 remained so due to the pandemic, this included 126 High Street, two floors at 2 The Billings (one now under-offer), 2 Thornberry Way (now under-offer), 126 High Street (now re-let) and 40A Castle Street (moth balled for disposal - awaiting Museum review). However, these were off-set by successful new lettings despite the difficult market (see key 5 transactions).

Whilst the income of the portfolio has stayed level 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.

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. The Asset Investment Strategy which was due to go to the Executive in March 2020 was delayed due to COVID-19 but finally approved by the Executive in September 2020. However, due to the pandemic there has been a lack of suitable stock in the market which resulted in only one acquisition taking place in 2020/21. It is hoped that with the relaxation of the COVID-19 restrictions the markets may open-up more in 2021/22 to allow further acquisitions. The Council's ability to source the right investment stock at the right price continues to be the biggest driver of performance.

KEY 5 TRANSACTIONS

	Property	Transaction
	10 Midleton	Void since 2019. New 15-year lease from 14/10/2020 at £326,729pa.
	The Hub, 1 Thornberry Way, Slyfield	Acquired in August 2019. New 10-year lease from 27/01/21 at £233,200pa.
	Fox's Garage, Midleton	Acquired in Sept 2020 for £500,000. New 5-year lease from 25/01/2021 at £40,600pa (GIY of 8%).
	1 North Moors, Slyfield	Surrendered at nil cost to Council in October 2019. New 20-year lease from 16/09/2020 at £40,000pa (100% increase in rental).
	23 Woodbridge Meadows	New 125-year lease from 26/10/2020 at £15,000pa to allow redevelopment of this and adjoining site.

LOCAL PROPERTY MARKET 2020/21 REVIEW

Activity across the UK commercial property sector ended a tumultuous year with capital values and rents becoming increasingly divergent at the sector level. Industrial uses strengthening while retail and office vacancy rates rose at record pace; a trend exacerbated by the response to the COVID-19 pandemic.

Industrial

Strong investment demand for industrial drove yields down to new levels. This was mainly due to the UK logistics market which witnessed a record year; the pandemic and ensuing lockdowns accelerated the shift to online. This led to a surge in demand from Ecommerce and Post & Parcel operators (e.g. Amazon). Despite not having a large logistics offering, industrial property within Guildford continued to perform well. A scarcity of supply, particularly for smaller sub-10,000 sq. ft. units, limited new build and strong levels of take up resulted in rental and capital value growth during the year.

The Council's redevelopment of Midleton (see section 'Major Projects' below) is one of very few pipeline developments in the Borough with the only other notable development being Aviva Investors' refurbishment of a 30,000 sq ft unit at Slyfield, to be launched in Q2 2021. Further news is awaited regarding land at Burnt Common which was released as employment land in the recent Local Plan and is the subject of a planning application.

Office

The trend for companies downsizing/reducing overheads, increasing tech / decreasing office numbers and increasing home working was intensified by COVID-19 and home working. Whilst many people started to return to the office in some form at the end of 2020/21, office occupiers were (and still are) unsure about space requirements and what they may need going forward. As a result, the availability of office space rose, seeing the strongest rate of increase since the global financial crisis[3]. Take-up in Guildford was at an all-time low in 2020, reported to be under 50,000 sq. ft, less than half the annual average take-up level in Guildford since the 2008 crash and almost a third of the pre-2008 average. The largest recorded deal in 2020 was the acquisition of the 29,170 sq ft Riverworks office for educational purposes by Department for Education generating a sale of £12.7m.

The absence of transactional evidence suggests that top rents are unchanged yet increasing incentives could be masking the falling effective rental levels. That said, there has been a slow increase in requirements which will hopefully transition to take-up later in the year (e.g. Unit 2, The Billings which is under offer at full market rent).

On a positive note, there is more interest in prime office demand, especially at the smaller suite end, where companies are downsizing or seeking to extract themselves from the capital but looking more for quality. Guildford has proven popular with gaming companies; Wargaming let additional space in 2020 in order to establish their UK Headquarters.

Retail

Retail property was undoubtedly strongly affected COVID-19 but this simply accelerated the existing structural challenges around online and omni-channel retailing. The crisis gripping the high street saw more retailers filing for CVAs and administrations, with Debenhams and Arcadia among the most notable casualties. Multiple/chain retailers were relatively inactive with Landlords favouring independent retailers looking for opportunities to open. However, these occupiers have a maximum rent and Guildford saw a reduction in rental levels from over £300psf ITZA in 2018 to c.£175 psf ITZA in 2020/21. Unsurprisingly, the online sector continued to perform strongly. Out of town retail warehousing was arguably the most defensive part of UK retailing against the rise of online retail sales, driven by affordability and stronger demands from retailers. There continued to be occupational activity particularly at the value end of the market (e.g. Lidl, Aldi, The Range, Home Bargains, etc.).

PROPERTY MARKET – OUTLOOK

There continues to be a range of forecasts, but recovery is expected to be strong as the economy gets back in gear, bolstered by the UK's highly successful vaccination programme. That's not to dismiss the still significant challenges faced by some sectors though, with structural forces set to considerably impact the way office and retail space is utilised over the longer term.

It is felt the office market will have a greater emphasis on health & wellbeing with fewer desks (but more desk space) alongside a greater share of collaboration and meeting space. Outdoor areas, amenities and fit-out will be top priorities and investment in environmental, social and governance (ESG) will accelerate with smart building technology and net zero carbon upgrades.

The speed of recovery in retail will depend on how quickly consumers spend the savings amassed during the pandemic. The next months will also provide a gauge on the propensity of some consumers to keep shopping online post-lockdown. However, many within the industry continue to advocate a wider reform of the business rates system.

The re-purposing of retail assets, the future demand for offices, and the growing importance of ESG issues and the evolving impact of Brexit are likely to be key issues for 2021.

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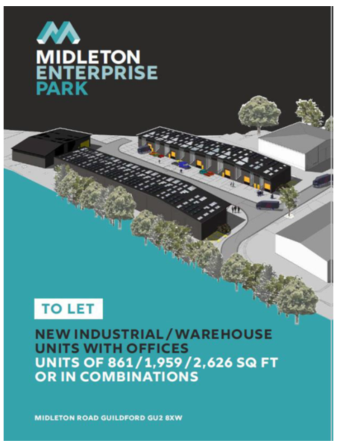
[3] RICS UK Commercial Market Survey, Q4 2020

MAJOR PROJECTS

Midleton Industrial Estate Redevelopment

The Council progressed the phased redevelopment of Midleton Industrial Estate during 2020/21 despite the issues regarding the pandemic.

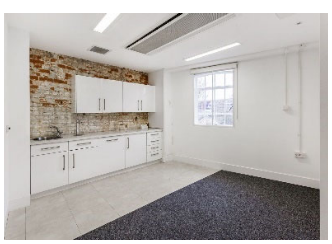
Phase 1 – This phase, the development of a pair of semi-detached industrial/warehouse units c. 10,000 sq.ft, with offices, was completed in 2020/21. Both units were let to a single tenant (new to Guildford) in April 2021 on a 10-year lease at £126,063pa.



Phase 2/3 - Demolition works of plots 12-15 were completed in 2020/21 and construction works are progressing at pace. It is hoped works will be completed in Autumn with some units already under offer.

Phase 4 - Design work for plots 3-5 and 9 got underway and a planning application was submitted and has subsequently been approved. It is hoped that the Council will be going out to tender for the works in Summer 2021.

Unit 2, The Billings, Walnut Tree Close



During 2020 the Council undertook a full refurbishment of Unit 2, including full internal redecoration to first, ground and lower ground floors, communal area and roof works. The refurbishment works successfully attracted two good lettings in a very difficult market. The lower ground floor let in November 2020 at a rent of £39,500 pa; and the first-floor accommodation is under offer.

The Hub, 1 Thornberry Way, Slyfield

In 2020 a refurbishment of The Hub was completed which included, stripping out the mezzanine floor and full warehouse racking, undertaking repairs to the concrete slab where necessary, and a full refurbishment of the office and kitchen area. The property was then successfully let in January 2021 at £233,200 pa.