

Title of meeting: Governance Audit and Standards Committee

Date of meeting: 21 January 2022

Subject: Property Investment Fund - Covid-19 Impact

Report by: Tom Southall

Wards affected: All

Key decision: No

Full Council decision: No

1. Purpose of report

- 1.1 To provide a summary of the response and impact of the Covid- 19 pandemic on Portsmouth City Council's commercial property investments.

2. Background

- 2.1. The Council's commercial portfolio consists of circa 550 agreements (or tenants), brings in rental revenues of £26 million per annum and is geographically spread across the UK.
- 2.2 For the purposes of this briefing note the 'commercial property portfolio' is not reported in relation to the Council's holding portfolios (Housing, Leader, Culture & Leisure etc.), rather the portfolio is split into three constituent parts, based purely on an assumption of holding purpose. These are;
- 2.2.1 Portsmouth Based Properties (£8 million pa) - these tend to be assets that have been held for a long time, are 'within the borough' and whose sole purpose for retention is not revenue generation.
- 2.2.2 Lakeside Portfolio (£8.2 million pa) - this consists of all lettings within the 136 acre Lakeside North Harbour business campus.
- 2.2.3 National Investment Properties (£9.25 million pa) - the properties within this category are held predominantly for their revenue and capital returns. Please note this category includes Portsmouth Retail Park, and assets at Dunsbury Business Park.
- 2.3 The Covid-19 pandemic imposed lockdowns on the population in 2020/21 which impacted on businesses across all sectors. In the commercial property investment markets the restrictions placed on the movement of people led to almost immediate 'work from home' requirements from employers, and a significant switch away from shopping physically in store, to online shopping. These changes came about almost

overnight in the first lockdown and as a result, severely affected activity in the commercial property investment markets in 2020.

- 2.4 Toward the second half of 2020 some recovery was seen in certain sectors, such as logistics and warehousing which supports online shopping.
- 2.5 During 2020, the government was fast to intervene to support businesses and their employees. Financial assistance included the furlough scheme, direct grants for small and medium sized businesses, extensions to rate exemptions and other small business grants. Local businesses were encouraged to make use of this help through regular contact with their Local Authority's economic development teams, including those at PCC.
- 2.6 The government also made concessions in the wider residential property market with measures including an extension to the stamp duty holiday for residential transactions, which led to a general increase in transactions towards the middle of 2021.
- 2.7 It is worth noting however, that assistance has not been directly offered to commercial landlords when tenants were unable to pay their rent. In fact, since March 2020, restrictions on commercial landlords' ability to recover rent arrears from their tenants has been significantly restricted by government intervention to prevent use of some of the usual remedies available, via the Coronavirus Act 2020. These include restrictions in use of Statutory Demands and uncompromising restrictions on the use of the Commercial Rent Arrears Recovery (CRAR) process. The latter was a well-used measure prior to the pandemic and enabled landlords to take steps to recover rent arrears once it was 7 days overdue. CRAR can only now be used to recover rent more than 554 days old and is little used as a result of the restrictions. It is expected that this will be reviewed again in March 2022.
- 2.8 In June 2020, the government published a code of practice for Landlords and Tenants to encourage communication and provide transparency between the parties in the event of non-payment of rent. The code was not legally binding, but was a positive step, as it provided a framework to encourage tenants to bring key information forward so that landlords could consider what help might be provided and what risk those decisions might pose. The code was updated in November 2021 and remains voluntary, although this position is under review. The code has been adopted by the PCC property management team since its introduction in June 2020.

PCC Commercial Tenant Support Scheme

- 2.9 At the start of the pandemic, it was agreed with the S.151 Officer that assistance by way of rent-free periods would not be offered to commercial tenants, only reasonable deferrals and/or a temporary changes to payment frequencies would be acceptable proposals. In April 2020 (and in advance of the code being published), PCC's commercial property team setup an online portal for all of its tenants, with the aim of streamlining the process for requests for help with rent payments. The portal encouraged tenants to provide a summary of assistance received from central government and prompted submission or commentary on business plans where available, so that tenants were able to ask for a rent deferral and/or to move rental payments to a monthly frequency. This allowed PCC as landlord to have a better

understanding of their respective trading positions and enable targeted support. PCC were not in a position to waive rent payments or to offer rent free periods.

- 2.10 Debts continued to be monitored closely between finance and property teams to ensure that all measures available, including any offers of assistance if appropriate, were discussed and agreed swiftly.
- 2.11 The first application via the portal was received in April 2020 and the portal was closed to new applications at the end of September 2021. The number of applications received while the portal was open was 127.

Financial returns

- 2.12 Please see Confidential Appendix A
- 2.13 Please see Confidential Appendix A
- 2.14 Please see Confidential Appendix A
- 2.15 Year-end Rent Rolls

| | Rent Roll 31.3.20 | Rent Roll 31.3.21 |
|----------------------------|------------------------------|------------------------------|
| National Investment | £9,000,000 pa | £9,250,000 pa |
| Lakeside | £8,963,124 pa | £8,293,277 pa |
| Portsmouth | £8,290,000 pa | £7,940,889 pa |

- 2.16 Year-end Portfolio Valuations

| | 31.3.20 | 31.3.21 |
|----------------------------|----------------|----------------|
| National Investment | £183,200,000 | £190,160,000 |
| Lakeside | £138,000,000 | £138,855,000 |
| Portsmouth | £193,991,367 | £192,317,464 |

- 2.17 In the Investment Fund the investments are spread across asset classes which have weathered the stagnation in the commercial investment markets well, particularly in logistics and warehousing.

- 2.18 In contrast, the office investment market at Lakeside remains quiet and growth in capital values has been suppressed as a result.
- 2.19 A drop in capital values between the two years in the Portsmouth portfolio is due to the make-up of this portfolio being of much wider spread of asset classes, a higher number of smaller value assets largely let to weaker covenants who were not as resilient to the impact of Covid-19.
- 2.20 In the Investment Fund, the principles of management remain on an asset by asset basis to ensure the strategy for income growth and capital values are carefully balanced whilst they are held in the Fund. There have been some tenant failures; one larger failure, Roanza Limited, based in Warrington, which fortunately did not result in a vacant unit as the Administrators continued to trade from the building and continued to pay rent. This is affording the Fund time to consider all of the redevelopment opportunities in a buoyant logistics market. The other failure resulted in a vacant unit, which is a small first floor office at Portsmouth Retail Park, vacated in 2020. Marketing has resulted in a good level of interest in the last two months of 2020, with re-occupation expected in Q2 2022.
- 2.21 At Lakeside, the autumn of 2020 saw good levels of enquiries from new occupiers with take up of smaller office suites (under 3,000 sq ft) being strong. A lack of good quality stock on the M27 corridor has actually led to an increase in the headline rents being achieved, now at £23 per sq ft, compared with pre-pandemic levels of circa £21 per sq ft. There are approximately 55 tenants at Lakeside and some turnover of tenants leaving and new ones taking up leases is considered normal. Anecdotally there has been a trend from occupiers to downsize at lease expiry, but this is masked to some degree by new occupiers filling the spaces created. There were no tenant failures due to the pandemic.
- 2.22 In the Portsmouth portfolio, a number of occupiers have struggled, the most notable failure being Your Centre Limited who occupied space in the Civic Offices, leaving a significant debt to pursue once the company went into administration, then liquidation and the lease was disclaimed.

3. Legal implications

- 3.1 None.

4. Director of Finance's comments

- 4.1 The Council have bad debt provisions of £1.273m in place for outstanding rental payments where there is a risk of non-recovery as detailed in the table below.

| | Sep 2021 | Mar 2021 (Y/E) |
|----------------------------|-----------------|-----------------------|
| National Investment | £521,125 | £593,000 |

| | | |
|-------------------|----------|----------|
| Lakeside | £207,000 | £169,000 |
| Portsmouth | £469,000 | £511,000 |

Overall, there has been a slight improvement in the bad debt position. The debt for Your Centre Limited mentioned in the report is 100% covered by the provision.

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Signed by:

Tom Southall, Assistant Director Property & Investment