REPORT

SUBJECT:	**Investment Committee Review**
MEETING:	**Performance & Overview Scrutiny Committee**
DATE:	**15th January 2024**
DIVISION/WARDS AFFECTED:	**All**

1. PURPOSE:

1.1 To provide members of the Performance & Overview Scrutiny Committee with an update on proposed governance changes to the Asset Investment Policy, together with a performance update on the Council's commercial property and investment portfolio.

2. RECOMMENDATIONS:

2.1 To receive a verbal update at the meeting following consideration of the proposed governance changes to the Investment Committee at its meeting on 9th January 2024.

2.2 To consider and scrutinize the proposed, revised governance arrangements contained in the revised Asset Investment Policy (appendix 1) and summarized in section 4 of this report, and to endorse or otherwise such changes being proposed to Council at its meeting on 18th January 2024.

2.3 To receive a performance update on the Council's commercial property and investment portfolio, subsequent to update considered by the Investment Committee on 28th November 2023.

3. KEY ISSUES:

<u>Background</u>

3.1 In May 2018, Council approved a revised Asset Management Strategy, which included an Asset Investment Policy designed to optimize returns from the Council's investment portfolio, including the acquisition or development of new assets or other commercial opportunities.

3.2 The purpose of the policy was to support the Council delivering against its core policy objectives whilst helping sustain Council services and enhancing its asset base. The policy provides a framework to enable the acquisition of commercial assets to increase net rental income streams and realise capital appreciation opportunities.

3.3 The Asset Investment Policy outlined the criteria for evaluation of commercial and property investments, measured against the potential income generation opportunities to satisfy the Council's then Corporate Plan and in supporting its wider budget framework.

3.4 The policy set out the need to seek out investment opportunities within Monmouthshire, the City Deal region and neighbouring areas of economic influence, which supported the Council's economic and regeneration priorities. The policy enabled the Council to identify investment opportunities beyond our county boundary that met the investment criteria as well as identified different types of investment that would diversify the portfolio and minimise risks by both sector and location.

3.5 Alongside the policy, the Council at that time approved £50,000,000 of prudential borrowing that could be used to acquire or invest over a three-year period. The cost of borrowing is serviced by the resulting rental streams, with a requirement that it should provide a net surplus over and above borrowing costs.

3.6 The Investment Committee, which currently presides over the monitoring of performance updates, is made up of the Council Leader, Deputy Leader, Cabinet Member for Resources and Leaders of the two largest opposition parties. The Committee is advised by the Deputy Chief Executive (s151 officer for the Council) and officers from Finance, Landlord Services and Legal Services. When previously considering acquisitions or investments, specialist advisors have been used to supplement internal capacity and expertise as appropriate.

The Asset Investment Policy

3.7 The Asset Investment Policy sets out the framework and governance criteria for the management of the investment portfolio. The policy stipulated that the returns must exceed borrowing costs by a minimum of 2% per annum and over its expected lifetime (ROI). The Asset Investment Policy enables individual investments to provide a lower return (i.e. below 2%) if investments can demonstrate economic development opportunities for Monmouthshire or alignment to other policy objectives. However, in such circumstances borrowing costs must at least be covered.

3.8 All business cases received by Investment Committee considered the known risks at the time of the investment, together with the proposed mitigating action and potential exit strategies.

3.9 The Investment Committee has been responsible for making decisions on possible investments based on the business cases presented, ensuring that they met the criteria as set out in the Asset Investment Policy. In addition, the Committee has been responsible for ensuring that the assets are effectively managed, performance is monitored, and performance reviewed via an annual report to the Governance and Audit Committee.

Proposed Governance Changes

4.1 The Governance & Audit Committee received the last performance review of investment committee in November 2022. That update provided information on the local and national context and that included the strengthening of the Prudential Code and following moves by UK Treasury and the DMO (Debt Management Office) in restricting lending for commercial investments being entered into primarily for yield.

4.2 The Council paused any further active consideration of commercial investments activity as a consequence of the pandemic and the resultant uncertainty in property and investment markets. No investments have been made subsequent to the strengthening of the Prudential code and confirmation has been provided on an annual basis to the DMO that no PWLB borrowing is intended for the purpose of acquiring investment assets primarily for the purposes of yield.

4.3 As previously stated the Investment Committee established in 2018 to manage the investment portfolio had delegated authority to acquire or invest over a three-year period against a £50,000,000 fund established through approved prudential borrowing.

4.4 All three investments made by the Investment Committee to date had been made within the three-year period, the last of these in March 2020. The three-year period approved by Council in May 2018 has now lapsed. The expiry of this period and changes to the Council's commercial investment risk appetite has warranted a review of the governance arrangements around commercial activity, including the choice of appropriate fora to consider performance updates of the investment portfolio.

4.5 Furthermore, there remains a pause on further commercial investment activity and that has continued due to the ongoing market volatility since the start of the pandemic.

4.6 As a result of the Council's risk appetite and the ongoing strain on its financial standing any further investment will only be considered in order to support the core policy objectives contained within the Council's latest

Community and Corporate Plan, and where deemed prudent, sustainable and affordable.

4.7 If any future investment considerations are intended to deliver against direct policy objectives of the Council then it naturally prompts for the current governance arrangements and Asset Investment Policy to be reviewed.

4.8 In terms of any future investment proposals, these can be considered in line with the Council's current constitution and decision-making processes through Council, Cabinet or otherwise.

4.9 To the extent that an investment proposal contains commercially sensitive information then either the whole or part of the report can be considered to be exempt from the press and public.

4.10 Notwithstanding this it is proposed that the Investment Committee, as an existing sub-committee of Council, is retained but put in abeyance. This therefore allows Council in future, and if it so wishes, to request the Investment Committee to preside over an investment proposal before making recommendation back to Council for consideration. In such circumstances this will retain the cross-party scrutiny and consideration of any such investment proposals.

4.11 It is proposed that the role of the Performance & Overview Scrutiny Committee now focuses on maintaining oversight and scrutiny of the performance of the Council's property investment portfolio on a six-monthly basis.

4.12 Furthermore it is proposed that the Governance and Audit Committee looks to seek ongoing assurance on overall governance arrangements of the commercial and property investments as part of the Council's overall land and property portfolio.

4.13 The Asset Investment Policy and the associated terms of reference for the Investment Committee have been updated on this basis and are shown in appendix 1.

4.14 In order to ensure that effective consultation takes place the changes outlined in this report will be considered by Investment Committee, and then subsequently Governance and Audit Committee, and Performance and Overview Scrutiny Committee ahead of being presented to Council for consideration. Feedback will be provided at Council and to the extent of confirming that proposed changes are supported or otherwise.

Investment Performance Update

5.1 The Investment Committee received performance updates in July and November 2023, and January 2024. A summary below sets out the performance of Castlegate Business Park and Newport Leisure Park investments for the previous and upcoming financial years. It illustrates the impact of the pandemic on both assets, and the improving performance following lettings at both sites:

	Castlegate Business Park	Newport Leisure Park
ROI at time of acquisition	3.76%	2.11%
ROI as of 22/23	-6.58%	0.01%
ROI as of 23/24 (Nov 23)	-2.85%	1.13%
Forecast for 24/25	0.43%	2%
Occupancy at time of acquisition	95%	100%
Occupancy as of 22/23	75.7%	97%
Occupancy as of 23/24 (Nov 23)	85.6%	97%

5.2 Figure 1 above captures a summary of the financial performance of the investment portfolio. This equates to a £363,474 improvement in the performance of the investment portfolio from 22/23 to 23/24. Both Castlegate Business Park and Newport Leisure Park (NLP) are projected to generate a net surplus, after borrowing repayments, in 24/25.

5.3 The 24/25 forecast is based on the expiry of rent-free periods or uplifts (i.e. stepped rentals) captured within existing lease agreements. The forecast does not reflect the anticipated positive effect of any additional vacant space being let.

Castlegate Business Park

5.4 Castlegate Business Park was acquired in June 2018 for £7million together with a service charge loan of £900k and associated acquisition costs. The asset consists of mixed office and production/warehouse space amount to circa 217,000 sqft situated in 18 acres of land adjoining the Caldicot settlement.

5.5 A new letting to Wunda Group, the largest single occupier of the property, has reduced the vacant space by a further 22,336 sqft. Combined with a small letting to an existing occupier, this has reduced the vacant space from 52,765 sq ft as of December 22 to 29,933 sqft as of November 23. The letting has also secured an extension to the remaining term of Wunda Group’s existing occupancy.

5.6 To assist with reducing the vacant space and tailor to smaller occupiers, a marketing campaign has been launched for ‘MonSpace’, a flexible co-working environment from which meeting rooms and office spaces can be hired on flexible terms. Unit 120 consists of 9 suites that lend themselves to this arrangement. Two of the suites have been let including to a local businessman and Caldicot Town Council (who are seeking temporary accommodation whilst their existing premises is refurbished). These lettings are contributing a rental income to MCC and reducing our service charge, business rates and utilities liability.

5.7 Given that the asset currently performs below the 2% above borrowing criteria as set out in the asset investment strategy, Investment Committee has been obliged to review the retention of the asset and consider its disposal. On balance, it is the recommendation of officers that Investment Committee continue to hold this asset to retain a strategic employment asset, on the understanding of having continued to secure new lettings and increased the rent roll, reducing MCC’s service charge, business rate and utilities liability. The asset continues to support policy objectives around employment space and business development, and the financial liability to the authority continues to reduce as the asset’s net contribution to the authority is improving, with a project net return by 24/25 without any further lettings.

Newport Leisure Park

5.8 Newport Leisure Park was acquired in March 2019 at a cost of £22.5million. It is situated on the Newport/Monmouthshire border and comprises of a mix of six restaurants, two retail units and three leisure units within an 11 acre site. At the time of acquisition, all of the units were let on the basis of long leaseholds with no rental or service charge arrears.

5.9 Since the last performance update in November 2022, MCC have secured new tenants for Unit 2 with a letting to Active Parks Limited, trading as Innoflate. A letting of Unit 5 has also been completed to Magic Bean Company (Starbucks) who have completed construction of a drive-through and commenced trading in September 23.

5.10 There is one remaining vacant unit on the property. Unit 6 is being marketed and negotiations are ongoing with a prospective occupier. One tenant is in arrears and we are engaging in discussions with them on debt repayment or commencement of recovery proceedings.

5.11 Unit 1 (let to Cineworld) continue to satisfy their lease and rental obligations in full. On August 1st the Cineworld Group emerged from its Chapter 11 bankruptcy notice, reducing their debt and introducing a new management structure and board. There has been no indication that Cineworld will elect to close their cinema at NLP, however we continue to monitor the situation closely.

5.12 Whilst it is recognized that the ROI is below that of the 2% target as per the asset investment policy, it is recommended that the asset is retained, as the Leisure Park continues to generate a strong net return to MCC. Any sale is likely to also result in a depreciated capital value due to the reduced rent roll and limited investment activity in the sector at this time.

Broadway

5.13 In March 2020, on the basis of the completed due diligence and legal negotiations, the Council agreed to provide loan funding to Broadway Partners Limited (through a Special Purpose Vehicle or SPV: 'Monmouthshire Broadband Limited') which had the aim of supporting the construction of a broadband network across Monmouthshire to improve digital connectivity for rural businesses and residents.

5.14 Loan funding of £1.9 million was approved for a 10-year term, secured against the network assets held and created by the investment made by the SPV. Furthermore, an unsecured revolving loan facility of £300,000 was provided to Broadway Partners Limited to assist the company in overcoming cash flow delays resulting from delays in UK Government gigabit voucher scheme payments.

5.15 Monmouthshire Broadway Limited drew down two of the four tranche payments, total amount £1.15 million, of the £1.9 million total secured loan, repaying the loan plus SONIA-linked interest on a monthly basis, in accordance with the provisions of the Facility Agreement.

5.16 In October 2021, Broadway Partners secured consent from the Council to grant security to its new investors – Downing LLP – who sought to invest £145 million in the company to enable it to deliver full-fibre broadband to 250,000 premises in rural communities.

5.17 In November 2021, Broadway Partners repaid in full and with the necessary interest the balance of the revolving loan facility and gave the requisite notice that they wished to close the facility.

5.18 Unfortunately, on the 31st May 2023, Broadway announced that administrators had been appointed to enable them to restructure the business and a sales process to be undertaken. During this period, Broadway continued to trade and provide their usual services to both new and existing customers on their high-speed fibre network.

5.19 Upon the company going into administration the total principal balance of the MBL loan outstanding was £745,370.42, along with accrued interest outstanding.

5.20 Council officers worked constructively with the appointed administrators over a period of months and which culminated in a new buyer (Voneus Limited) being secured for Broadway Partners Limited. As part of the sale the Council was able to secure full repayment of the outstanding loan with MBL, together with all associated interest and costs incurred.

5.21 The Council no longer has any further financial exposure as a result of the administration process concluding itself. The Council will continue to separately support Voneus Limited with its plans to rollout full fibre broadband connectivity across Monmouthshire and as these become clearer.

Commercial Portfolio

5.22 The Council's industrial portfolio comprises of 40 units ranging in size from 365ft^2 to 2,850ft^2 located within Caldicot and Raglan. Currently the portfolio is 100% let and there are aged rental arrears in the region of £5k. A number of lease renewals are under negotiation at Old Pill Farm Industrial Estate which are anticipated to increase rentals.

5.23 The retail portfolio is made up of 23 secondary neighbourhood units, which are a combination of freehold and long leasehold tenures. The portfolio is 95% let, with a small number of voids at Hanbury House in Chepstow. The former OSS and hairdressers at Monmouth Market Hall is being advertised for prospective tenants.

5.24 Innovation House, Magor is categorised as an investment asset with an income target of £156,000. The ground and first floor had been let as a Welcome Centre as part of MCC's Ukrainian Relief efforts. The second-floor larger wing was vacated in November 23 by BAM Nuttall. The second-floor small wing remains occupied. Following withdrawal of the Welcome Centre, the offices continue to be marketed. Heads of Terms have been received from a prospective occupier, with negotiations ongoing regarding a potential co-working operator.

5.25 There are £9k of arrears for County farms, relating to one farm in Leechpool. Site visits have been arranged to discuss options with the tenant. Significant rental uplifts have been achieved across multiple recent farm lettings. Another farm is scheduled to be vacated in April 2024, where there is also confidence of an increased income following re-letting.

5.26 Income from the Council’s solar farm is currently forecast to meet the projected income target based on current performance and market rates for the sale of energy. Weather, grid outages and unforeseen maintenance issues may impact the final position.

6. OPTIONS APPRAISAL:

6.1 The report is not a decision-making report. The report represents a performance review of the Investment Committee, proposed governance changes and update on the performance of the portfolio. Therefore, no option appraisal is required.

7. REASONS:

7.1 The Asset Investment Policy requires an annual performance review of the Investment Committee to be undertaken in order to ensure that the governance arrangements, policy documentation and legislation are being adhered to and reviewed and revised as required. This report proposes governance changes that result in responsibilities for performance monitoring and scrutiny transferring to the Performance and Overview Scrutiny Committee.

8. RESOURCE IMPLICATIONS:

8.1 The three investments acquired since the introduction of the Asset Investment Policy in 2018 are the acquisitions of Castlegate Business Park and Newport Leisure Park, and the investment in Broadway Partners Limited. £30.7m of the £50,000,000 prudential borrowing fund had been spent on these three investments. Any costs of due diligence and advice incurred exploring other commercial investment opportunities have been met from existing revenue budgets.

8.2 As a result of the investments, budgeted income targets have been introduced. Since the time of purchase, the budgeted income targets have been reduced to reflect the expected short-term rental reduction as a result of the Mitel surrender at Castlegate and a turnover of tenants at NLP. As a consequence, the £609,000 original budget surplus has reduced to £217,000 in 2023-24. The latest Month 6 projections estimate a net surplus on NLP of £291,000 and a deficit of £216,000 on Castlegate, a combined surplus on both investments of £75,000 resulting in an in-year forecast budget pressure of £142,000.

8.3 As a consequence of the lettings to Wunda Group but ongoing rent-free period of Unit 5, the ROI’s for both investments have improved to 0.43%

and 2% respectively. It is forecast that both assets will return to a net return for MCC for the 24/25 financial year.

8.4 The capital values of both assets continue to be impacted by the respective sectors however an improving rent roll is resulting in capital appreciation. There are no significant arrears at Castlegate Business Park. One occupier of Newport Leisure Park is in arrears and discussions are ongoing with the tenants to establish recovery plans.

8.5 In terms of loan funding provided to Broadway Partners Limited, through a Special Purpose Vehicle 'Monmouthshire Broadband Limited', a positive outcome resulting from Broadway Partners Limited going into administration has led to a full repayment to the Council of the total principal balance of the loan outstanding of £745,370.42, along with all accrued interest due. The Council no longer has any further financial exposure as a result of the administration process concluding itself.

9. EQUALITY AND FUTURE GENERATIONS EVALUATION (INCLUDES SOCIAL JUSTICE, SAFEGUARDING AND CORPORATE PARENTING)

There are no equality and Future Generations implications arising from the purpose of this report. This report provides a performance review of the Investment Committee together with proposed changes to future governance arrangements.

10. CONSULTEES:

Stacey Jones – Finance and Resources Manager
Joanne Chase – Head of Commercial Law

11. BACKGROUND PAPERS:

Appendix A – Asset Investment Policy – as revised December 2023

12. AUTHOR(S):

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