

**SCRUTINY REVIEW PANEL-**  
**THE COUNCIL'S PROPERTY PORTFOLIO- THE NEXT 5/ 10 YEARS**

Report of the Strategic Head of Estate & Asset Management

**1.0 Matter for Consideration**

- 1.1 This report considers two key areas of the Council's real estate portfolio.
- 1.2 Tenanted Non-Residential Property (TNRP).
- 1.3 Investment and Development Account (I&D).

**2.0 Key Priorities**

- 2.1 The role of the Estate & Asset Management team is to support and maintain the delivery of safe and sustainable high quality commercial, investment and regeneration estate to support the delivery of key council objectives for benefit both residents, members and colleagues.
- 2.3 The operational estate must be considered through 3 key lenses Operational Suitably, Capital and Revenue Cost, Climate Action Now (CAN) Objectives
- 2.4 Commercial suitably – is the asset of the correct type and in the right location to deliver the best outcomes for the organisation when related to the reason it is held (market failure, investment, regeneration).
- 2.5 Capital and Revenue Costs – does the asset fit within modern budget profiles. Does it represent efficient use of resources. What are the future financial commitments related to the asset.
- 2.6 CAN Objectives – what is the carbon footprint of the property. What actions can reasonably be taken to move the asset towards net zero.

**3.0 The Current TNRP Portfolio**

- 3.1 The TNRP portfolio includes a wide range of land and property assets which are let to third parties. The definition TNRP is used in the same context as Non Operational or Investment Property and includes assets such as retail units, industrial units and commercial ground leases. In addition there are miscellaneous lettings which include agricultural holdings, telecoms apparatus and minor agreements relating to chief rents and garage/garden sites.
- 3.2 The current break down of the portfolio is as set out in the table below:

Asset Type	Number	Capital Value (Asset Report 19/20 £	Current Rental Income £
Commercial Ground Lease	204	49,000,000	2,865,879
Industrial Unit	28	2,254,000	185,000
Retail Unit	58	4,441,000	437,203

Misc Commercial Premises	38	25,578,000	2,976,746
Agricultural	22	810,000	32,018
Residential Chief / Ground Rents	488	n/a	1854
Misc Minor Lettings	474	n/a	177,300
Total	1312	82,100,000	6,676,000

#### 4.0 Purpose and Nature of the TNRP Portfolio

- 4.1 The diverse nature of the portfolio includes assets which provide a stable and relatively secure income stream. Others are more sensitive to economic forces and require greater management by the Council as landlord. The nature of the asset can however expand its role into other areas of Council activity beyond income generation which are set out in the report.
- 4.2 Commercial property is leased in a variety of formats depending on their purpose. In the majority of situations land and property is let on leases which are governed by the Landlord & Tenant Acts. This can provide for security of tenure for the tenant. In addition the leases will impose rights and obligations on each of the parties with regard to issues such as responsibly to maintain the premises and its use. Commercial leases conventionally make provision for the rent payable to be reviewed and the interval between reviews can range from annually to typically five yearly and sometimes beyond particularly in the case of older leases.
- 4.3 The implementation of rent reviews are undertaken by the Estates & Asset Management Department (Estates) by chartered surveyors who may negotiate settlements with surveyors employed by tenants to represent their interests. This is one part of the function provided by the department which also includes other aspects of the property management function which includes lease renewals, lease regears and lease management.
- 4.4 The degree of management required for each of the asset types differs as do the problems and opportunities they present.

#### 5.0 Asset classes within the Portfolio -

- 5.1 **Commercial Ground Leases (CGL)** - These leases are of a significant duration commonly 125 years. Older agreements can be of shorter and many of these are now reaching a life where tenants are seeking an extension or their renewal as the shorter the lease the less security they offer particularly for loan security purposes.

GCL offer a secure income stream secured on the buildings which are often constructed on the sites. In addition to the rental income the Council can obtain further revenue from lease re gearing whereby a lease is extended on payment of a single capital sum or premium.

- 5.2 **Industrial units** - The Council has two estates of nursery units located on the fringes of the town centre.

The units are occupied by a variety of small businesses who require smaller 'nursery units' particularly where they are new enterprises beginning to get established.

Due to the nature of the tenants these estates can require significant management and the recent economic situation has seen rent arrears and the liquidation of companies increase. The two estates are now approaching 50 years old and a lack of historic investment in the premises has resulted in fundamental maintenance issues such as defective roofs and services becoming an issue at both sites. This can effect the letting of the space and impact on rental income as outstanding maintenance may require a temporary rent free period to be granted to tenants whilst repairs are addressed. In addition the rent which can be achieved will be impacted by the quality of the space being offered

The units do offer valuable space to businesses seeking to get established in the borough providing employment opportunities and additional non domestic rating revenue.

- 5.3 Retail Units** - The Councils retail units are located across the borough in a mixture of small parades and a single precinct. Historically many of these sites provided a local shopping facility for Council tenants on adjacent estates. Typically the units have residential space on floors above which are managed separately by Stockport Homes Limited.

Changes in shopping practices have impacted on the viability of these premises and in certain locations the parades have been redeveloped to provide new residential accommodation.

The retail units are largely occupied by local retailers rather than national or regional businesses. Retail units can require significant management to address issue such as rental arrears but voids or empty units remain low as many tenants have been established for some time. The nature of the properties and their construction has caused maintenance issues at a number of locations requiring significant expenditure.

- 5.4 Misc. Commercial Premises** - These assets comprise a range of uses including sports facilities, and childrens day nurseries amongst others. They are located across the borough. Some of the facilities are associated with other Council buildings such as the day nurseries with schools and the sports grounds whilst managed by commercial tenants provide facilities to the wider community.

Certain of the assets are tenanted by larger enterprises including the hospitality & leisure sectors as well as the telecommunications industry however the majority are small businesses.

- 5.5 Agricultural** - The Council has a limited range of agricultural assets comprising one farm in Reddish Vale and land let on an agricultural tenancy in Cheadle. Other land comprises individual holdings which can be single fields ranging from an acre in size to larger areas which are let for grazing typically horses.

The grazing licences provide a modest income but provide a valuable function in ensuring that the Councils land is maintained and is not subject to unauthorized use or encroachment. Much of this land is contained within the Green Belt and its retention within the Councils ownership does provide a degree protection against development which may be contrary to the Councils policies.

**5.6 Residential Chief / Ground Rents** - The Council has approximately 488 Ground Rents and Chief Rents. Chief Rents are sums payable by a freehold owner of residential property to the Council and typically of a sum in the region of £ 5 per annum.

The total income derived from Chief and Ground Rents is £ 1854 per annum. Under the Rent Charges Act 1977 Chief Rents were given a life of 60 years meaning that they expire in 2037 beyond which date the freeholder will no longer have to pay the sum. The Act also made provision for the Chief Rent payer to redeem or purchase their Chief Rent for a multiple of the sum which they pay annually.

Ground Rents differ in that they are payable on properties which are held leasehold. Typically they relate to dwellings which have been sold leasehold for significant terms ie 999 years but retain the right for the Council to collect an annual charge similar in amount to a Chief Rent. Ground Rents are not covered by the same legislation as Chief Rents but for practical purposes they are treated as the same for the purposes of this report

Whilst there are private investors who have such assets in their portfolios both the Chief and Ground Rents present a significant management burden on the Department relative to the income they generate. The cost of raising an invoice and collecting payment far exceeds the income generated.

The Councils portfolio does not present the same negative characteristics which have been the subject of media interest recently and do not have the ability to be increased.

**5.7 Minor Lettings** - Include garden tenancies, garage plots let to residents. In addition rights granted over Council land such as rights of way easements and fishing rights.

The income generated from these lettings is modest and certain agreements are historic dating back a significant period of time which is reflected in the rent level collected.

## **6.0 Issues facing the TNRP portfolio**

The vast majority of the portfolio is historic some elements having been acquired by the Council prior to the establishment of Stockport MBC in 1974.

There have been few additions to the portfolio and disposals have been piecemeal in recent years and confined to those assets which were deemed surplus to requirements at the time and in situations where obtaining a capital receipt was considered to be more favourable than retaining a rental income.

## **6.1. The Age of the Assets**

CGL are interests which the Council has in land on which tenants have developed their own premises typically industrial units. Whilst ultimately leases are wasting assets when they reach the end of their term they do provide the Council with secure rental income for little management expenditure. Their reduction in length also present the Council with the opportunity to receiver premiums or capital payments from tenants to lengthen their leases or alternatively for them to be surrendered and re granted. There is also the option for the Council to enable the leases to effectively wind down with a view to it obtaining possession of the site at some date in the future so that it can redevelop the site. So far this option has not been explored.

Much of the other property assets are held under lease with varying obligations on the Council as landlord. Many commercial leases are held on what is known as FRI or Full Repairing and Insuring leases. In this situation the tenant is responsible for maintaining the property to a particular standard. In other situations the obligations can differ and the tenant is liable for only minor repairs with the Council responsible for the structure.

In certain situations a lack of investment in the assets has resulted in buildings now reaching the stage that has resulted in certain elements needing replacement such as the roofs at the industrial units and historic defects at the retail units. This can result in the Council incurring significant expenditure directly or indirectly through the grant of rent free periods to allow tenants to implement the repairs

## **6.2 Income vs Invoicing and Management Costs**

Some assets provide an income which is fixed but represent a significant cost to manage the clearest example being the Chief and Ground Rents.

Others by their nature such as garden and garage rents are at low levels due to their being historic in nature with the Council not taking the opportunity to review the rents payable.

## **6.3 The reason for their retention**

Scrutiny of the portfolio identifies assets which whist not highly performing from an income or capital appreciation perspective do provide a valuable function. In the case of agricultural holdings the Council as freeholder can have control over the use of the land and prevent its development for uses which it would not deem appropriate but may have difficulty in resisting if it were only to rely on its powers as Local Planning Authority. A similar situation relates to sports clubs Which whilst not generating significant income provide a wider service to the community promoting health and wellbeing as well as protecting land which is often Green Belt or Local Open Space.

Other assets such as industrial units provide a location for start-up and smaller businesses. It is fair to say however that such a function is also provided by the private sector.

Retail premises provide a local facility for residents close to their communities and this may be seen at Woodley Precinct which is a development of circa 20 units serving the adjacent Council estate as well as the private dwellings in the locality. They are particularly beneficial for residents who do not have access to private transport. The Council units are part of mixed commercial and residential development which would make their Management more problematic were they to be considered for disposal.

## 7.0 Investment and Development Account (I&D)

Asset Type	Number	Capital Value (Asset Report 19/20 £)
Total	22	93,450,000

### 7.1 Purpose and Nature of the I & D Account

The Investment and Development account is intended to deliver the following

- Support delivery of SMBC investment strategy including financial return, regeneration and risk
- Deliver and hold Regeneration projects
- Allow strategic land acquisition/land assembly

The nature and background of the assets held in the account is varied with a mix of residential, retail, industrial, leisure and commercial holdings. The key driver of the account is delivering regeneration schemes within the borough that deliver key economic benefits to the residents of Stockport.

The nature of the portfolio is commercially sensitive with the bulk of assets sitting in the development and regeneration stage.

### 7.2 Funding

The assets within the account have been largely funded by capital borrowing. All of the I&D assets have individual borrowing attached which needs to be serviced in line with the associated business plan under which they were acquired or developed.

The portfolio nature of the I&D means that we can take a blended risk approach across a variety of sectors. This allows the council to undertake challenging projects where we have seen market failure across the asset classes. We are able to deliver in the buoyant industrial market and use that success to support intervention in more challenging projects and areas.

The current assets are at varying degrees of maturity and a number still require further stabilisation which is underpinned and supported by those which have stabilised. As the assets in the fund mature we will look to move appropriate assets either in to the TNRP account as long term holds or dispose of the assets

in the market to recycle the capital into future development projects or to offset wider borrowing costs associated with the account.

## **7.2 Key Assets**

- Merseyway Shopping Centre
- Redrock
- Grand Central
- Aurora
- Stockport Exchange (various Phases)
- Edgeley Park
- Underbanks (inc White Lion & Winters Café)
- MDC Assets

## **7.3 Reporting**

The operational performance of the properties within the account are reported to relevant boards under which the asset is governed (i.e MDC Board, Merseyway Board) The boards will monitor the day to day performance relating to the assets, review the due diligence relating to key decisions and formulate the strategy that governs the future direction of the assets.

The overall performance of the account and the future direction of investment, divestment and overall Development and Regeneration Strategy is overseen by the Growth and Infrastructure Board and The Capital Investment Board.

These boards will ensure that the account is aligned to the Councils constitution and its key strategic aims.

## **8.0 General Estates Issues**

### **8.1 Management**

The Estates & Asset Management Department (Estates) does not have appropriate software to effectively manage the portfolio. Current systems are dated and do not provide the ability to interrogate leases to accurately establish the status of rental payments and arrears. In addition there is no system to bring forward lease events such as rent reviews and lease renewals meaning that there is a risk of a rent reviews not being implanted on the correct date leading to lost income.

Progress is being made to identify a suitable software package to perform this function. A business case will be established to justify the expenditure needed to acquire the software.

Rent arrears are a feature of commercial property and are not unique to this Council. There are deficiencies in the Council systems in identifying and pursuing rent arrears as set out above. In addition the link up between the Estates financial systems and the Councils SAP Financial system is problematic and inefficient. Action is being taken to address this but this is anticipated to be only a temporary measure until a more comprehensive and joined up system

can be acquired and implemented. Ultimately legal action can be required to recover rent arrears and this requires resources which may not be available internally requiring the use of external expertise at a cost.

Estates is one full time member of staff short due to the inability to attract staff with the required skills and qualifications. This is being addressed with a view to filling the post. This should provide additional capacity to address this and other outstanding management issues.

## **8.2 Economic Issues**

In common with many landlords the pandemic has affected the ability of tenants to meet their rental commitments leading to arrears.

Under the Coronavirus Act the Govt introduced legislation which restricted the ability of commercial landlords both to forfeit (take back) leases for non-payment of rent and to seize goods in payment of rent arrears under the Commercial Rent Arrears Recovery (CRAR) procedure. This has been the subject of a number of extensions as the scale of the pandemic grew and the last extension was from June 2021 to the 25<sup>th</sup> March 2022.

In November 2021 the UK Govt introduced the Commercial Rent (Coronavirus) Bill which it is expected to become law and brought into force on or before the 25<sup>th</sup> March 2022. This will introduce an arbitration process should landlords and tenants be unable to reach agreement on rent arrears debt accumulated during Covid restrictions for the period March 2020 and July 2021. Precise detail as to how the system will operate is not yet available but the government's intention appears to be that any pain is shared between landlords and their tenants.

Unfortunately during the period a number of Council tenants have gone into liquidation as a consequence of the pandemic.

The current rent arrears debt within the TNRP is £ 1.16m (excluding individual debts of below £ 1k). The arrears are owed by 189 tenants. Some 32% of the arrears are owed by two individual tenants and the Council are in the process of resolving these debts. A significant proportion of these arrears have arisen in the approximate two-year period of the pandemic and will be addressed in line with the legislation to be introduced by the Govt this year.

## **9.0 The Next Steps**

9.1 Estates propose to implement the following measures to address the issues raised in this report:

- a) Identify and acquire software to provide a modern property management system to enable the efficient management of the portfolio ensuring revenue is maximised and staff time is employed effectively
- b) Work with the Councils Finance Team to advance links between the two departments IT systems to improve rent collection and minimise arrears
- c) Introduce additional staff with the relevant skills to improve the ability of department to meet the demands of managing the portfolio.



- d) To establish whether any short term measures can be introduced to deal with any back log of current work streams for example rent reviews by external consultants.
- e) Work in conjunction with the Councils Legal Department to establish the feasibility of dealing with the Chief and Ground Rents with view to their disposal thereby relieving the Council of their management liability whilst protecting the interests of the boroughs residents and the Council as freeholder.
- f) Continue to interrogate the portfolio to identify assets which may be felt to be underperforming and identify their suitability for disposal.
- g) Implement the Govt legalisation being introduced to deal with rent arrears accrued during the pandemic

## **10.0 Recommendation**

The CRMG Scrutiny Panel is recommended to:

1. Note the contents of this Report.
2. Endorse the implementation of the Next Steps as set out in the report.