SPELTHORNE BOROUGH COUNCIL

Property and Assets Annual Report – 31st March 2020

Asset Manager's Report

Introduction

The Investment report is produced by the Asset and Property Team at Spelthorne Borough Council. It includes an analysis of the commercial property portfolio owned by the Council as at 31st March 2020.

The commercial portfolio is wholly owned by Spelthorne Borough Council. The Portfolio objective is to generate revenue to support the services delivered by the Council to residents and businesses of Spelthorne including the delivery of housing for residents.

The withdrawal of Central Government funding has meant that Councils across the UK have had to find alternative methods to fund vital services within their boundaries. Spelthorne Borough Council has sought to invest in commercial property, through borrowing at very competitive fixed rates of interest mainly from the Public Works Loan Board.

By 2018 the Council had acquired a portfolio of sufficient size to reverse the funding cuts and were in a position to focus on the delivery an ambitious housing programme and regeneration projects. In line with the Capital Strategy the Council's acquisition strategy is now focused on regeneration and housing opportunities rather than income generating assets. To reflect this we now have an investment portfolio and a regeneration portfolio, which are covered in different section in this report. Collectively, these two portfolios are referred to as the commercial portfolio in the report.

Commercial Portfolio Key Facts

Net Asset Value 31 March 2020	£1.026 billion
Number of Property Holdings	11
Average Lot Size	£93.27million
Total Passing Rent (per annum)	£46.97 million*
Estimated Rental Value (per annum)	£54.28 million**

* Contracted rent assumes rent free periods have expired, excludes guarantees & Elmsleigh Centre.
**Excludes Elmsleigh Centre.

Portfolio Analysis

Property Valuation

The investment property portfolio is independently valued annually at the 31st March to comply with the Council's accounting obligations. At 31st March 2020, Carter Jonas LLP valued the portfolio at £986.67 million (excluding the Elmsleigh Centre). Carter Jonas LLP were appointed in 2018 on a two year contract to undertake the annual property portfolio valuation. The portfolio was valued on an open market basis in accordance with the RICS Valuation Global Standards 2020 incorporating the IVSC International Valuations Standard also known as the "Red Book".

Since March 2019 the Council has acquired the Summit Centre, Sunbury and the long leasehold interest at The Elmsleigh Centre for regeneration purposes. The portfolio now includes 11 direct holdings with a net asset value of £1.026 billion. The commercial portfolio (excluding the Elmsleigh Centre) produces an annual passing rent of £46.97 million (£45.79 million per annum – December 2019). This is an increase of £3.67 million per annum following the letting activity completed across the portfolio during the last 12 months. The passing rent is the rental income due under lease contracts excluding any rent free periods.

The table below lists the Council's investment and regeneration assets in hierarchical order based upon capital value. It shows the current book value of each property as provided by Carter Jonas. The Elmsleigh Centre was not independently valued at 31st March having been purchased in February 2020. The acquisition was an open market transaction and so the Council has relied upon the valuation at purchase.

The valuation reflects increased market uncertainty due to the global Covid-19 pandemic which started to affect the commercial real estate markets towards the end of March, i.e. just prior to the valuation date. Carter Jonas have confirmed that their approach is consistent with market sentiment.

Commercial Property Assets (investment and regeneration portfolios) – Valuation table.

Assets	Portfolio	Sector	Value (£m) March 2019	Value (£m) March 2020
BP Campus, Sunbury Business Park, Sunbury	Investment	Offices	389.08	391.73
12 Hammersmith Grove, London	Investment	Office	170.80	165.90
Charter Building, Uxbridge	Investment	Office	135.40	131.20
Thames Tower, Reading	Investment	Office	127.20	126.80
The Porter Building, Slough	Investment	Office	71.40	69.90
World Business Centre 4, Heathrow	Investment	Office	47.00	45.80
3 Roundwood Avenue, Heathrow	Investment	Office	20.55	20.10
Communications House, Staines	Regeneration	Office	15.40	14.50
Elmbrook House, Sunbury	Investment	Office	7.46	7.24
Sub-Total			984.29	973.17

Properties acquired since March 2019.

Assets	Portfolio	Sector	Value (£m) March 2019	Value (£m) March 2020
Summit Centre, Sunbury	Regeneration	Offices /Ind	N/A	13.50
Elmsleigh Centre, Staines	Regeneration	Retail	N/A	39.33
Sub-Total				52.83

Total	**All Properties**		**£984.29m**	**£1.026 bn**

Key Performance Indicators

The Council has set a number of key performance indicators for the commercial portfolio which were published in the Capital Strategy 2020. The performance measures are currently under review and will be re-assessed as part of the Capital Strategy update. The commercial portfolio as a whole fell in value over the last 12 months by -1.13%. With the exception of Sunbury Business Park all the commercial properties valued at 31st March 2020 decreased in value. This figure does not include the Elmsleigh Centre and the Summit Centre which were not held for the full year. This was driven by the uncertainty in the occupational market due to Brexit and at the end of the year due to the Covid-19 pandemic. The Monthly All Property Index produced by MSCI recorded a substantial decrease of 2.4% in capital values for March. Across different sectors performance varied, with offices showing capital value growth of -1.4% and retail being the worst affected with capital value growth of -4.8% in March[1].

The total amount invested by the Council since 2016 is £1.017 billion. The portfolio is now valued at £1.026 billion. Since 2016 there has been a positive return on the acquisition price with capital growth of 0.86%.

The management strategy of the investment portfolio focuses on protecting and optimising the rental income, over capital growth. The income yield for the portfolio (excluding the Elmsleigh Centre) at the 31st March was 5.2%. The income yield or initial yield, being the annualised rent expressed as a percentage of the property value provides an indication of the investment return. It is a good guide to the quality of the investment, with a high quality investment expected to produce a low initial yield. When acquiring property the Council is seeking to balance a good quality asset with a yield profile sufficient to meet the loan repayments, sinking fund contribution and the net income required to cover the Council's business activities (known as the 'triple net income'). The portfolio initial yield demonstrates that the Councils holds a portfolio of good quality assets. The initial yield may not indicate the continuing income return as the current income level is not always a good indicator of future income levels.

The portfolio has a vacancy rate of 8.4% reference by floor area or 7.7% when calculated as a percentage of the portfolio rental value. The vacancy rate has reduced from 14% (based upon floor area) in March 2019 due to a number of successful lettings during the year. Whilst some floor space remains unlet the Council benefits from rental guarantees on all the void space which were agreed on the acquisition of Thames Tower, the Porter Building and the Charter Building. The guarantees cover all the void costs; rent, service charge and insurance for a period of two years at Thames Tower and the Porter Building and four years at the Charter Building from the date of acquisition (August 2018). The rental guarantees ensure that the portfolio is fully income producing.

Key Performance Indicators

Portfolio Capital Return (acquisition)	0.86%
Portfolio Capital Growth (last 12 months)	-1.13% *
Portfolio Income Yield at 31/3/2020	5.2%***
Sinking Fund income cover	5.19 months
Investment Cover Ratio	1:5**

[1] JLL Monthly Property & Economic commentary April 2020

Vacancy Rate – % of floor area	8.4%***
Vacancy Rate - % of market value/ERV	7.7%***

*excludes Summit Centre & Elmsleigh Centre
**Investment portfolio
***excludes the Elmsleigh Centre

The Council has been prudent in its approach to protecting the net income payable to the Finance Department by establishing a sinking fund. A proportion of the rental income is reserved on a quarterly basis to cover all capital and revenue costs associated with the properties. This may include rental voids, marketing costs, refurbishment costs which are not recoverable from the tenant and the potential cost of redevelopment. As at the 31st March 2020 the Council accumulated a sinking fund balance of £20.3m (as at 31 March 2019 the sinking fund balance was £10.6 million). The sinking fund is the equivalent to 5.19 months of the portfolio passing rent. At this level the sinking fund would cover 25 months of the net income payable to the Council. In addition it is projected that further contributions will be made based upon anticipated revenue over the coming years.

In the current climate it is acknowledged that the sinking fund may need to cover rental voids as a result of tenant defaults and rent concessions offered to assist tenants survive the economic crisis. The Council's approach towards ensuring financial stability includes modelling scenarios on the sinking fund. As a result of Covid-19, the worse-case scenario sinking fund analysis has been extended to cover the next 10 years. The sinking fund analysis is an extended cashflow highlighting anticipated income receipts and expenditure over a 10 year period. The assumptions within this analysis are constantly adjusted to take account of tenant discussions, market intelligence and any significant changes in tenant covenant status/financial position. In the Covid-19 climate these assumptions have included scenarios on major tenant defaults at an early stage in the cashflow, to stress test the resilience of the portfolio.

Even with extremely bearish assumptions, the analysis confirms that the sinking fund reserve should remain in a healthy position over the next 10 year period.

The main source of funding for the Council's acquisitions has been the Public Works Loan Board which offers long term loans at low, fixed rates of interest. This provides certainty over repayment costs. The Council seeks to ensure that all loan and interest repayments are adequately serviced by focusing on maximising the portfolio income. As at 31st March the net income covered the Council's costs of borrowing at a ratio of 1:5.

Investment Activity

Over the last 12 months the Council acquired two properties; the Summit Centre, Sunbury and the long leasehold interest in the Elmsleigh Shopping Centre, Staines. Both of these acquisitions were in-borough and reflect the Council's strategy to focus on regeneration and increasing the housing provision in Spelthorne.

On 23rd September 2019 the Council completed the investment acquisition of the Summit Centre, Sunbury-upon-Thames for £13.785 million. The Summit Centre is mixed office and light industrial park, developed during the 1970's and 1980's comprising of two office buildings (units 3 & 4), a standalone office/industrial unit (33 Hanworth Road) and a terrace of six industrial units. Johnson Controls/ADT Fire and Security plc, is the largest tenant occupying 56,294 sq.ft. The site of 4.47 acres has the long term potential to provide residential units to meet the Borough's ambitious housing targets. Units 3 & 4 have already secured permitted development rights approval for a 100 unit conversion to residential. In the short to medium term the Summit Centre provides an income return for the Council with a current passing rent £1,015,500 per annum.

On the 3rd February 2020 the Council completed the acquisition of the Elmsleigh Shopping Centre, 1-6 Friends Walk, 77 High Street, 91-93 High Street, 101-103 High Street (rear only) together with the Elmsleigh and Tothill multi-storey car parks in Staines from Maizeland Ltd and Arringford Ltd managed by Aberdeen Standard Investments at a price of £39.325 million. The acquisition reflected a net initial yield of 8.97% and an equivalent yield of 7.89%.

The Council already owned the freehold interest and therefore the acquisition represented the purchase of the long leasehold interest (250 years from 4 October 2006) in the Elmsleigh Centre and car park and the long leasehold interest (115 years from 11 July 1988) of 1-6 Friends Walk and Tothill car park. The acquisition also included the freehold interest of 77, 91, 93, 101-103 (rear only) High Street which adjoins the Elmsleigh Centre. The acquisition merges the freehold and long leasehold interests consolidating the Council's ownership of the Elmsleigh Shopping Centre, associated retail units and the multi-storey car parks.

The Elmsleigh Centre is central to the retail offer of Staines, the shopping centre provides 244,023 sq.ft of retail space, divided into 43 units, with anchor tenants including Primark, Matalan and Decathlon. The scheme provides a gross income of £4,340,107 per annum.

The Council recognised the importance of the Elmsleigh Shopping Centre for the prosperity of Staines and the wider borough. The Council has ambitious regeneration plans for Staines town centre and is already invested in a number of key town centre sites including Communications House, Thameside House, Hanover House and the Oast House/Kingston Road car park site. The acquisition of the Elmsleigh Centre is important to ensure a co-ordinated and holistic approach to the regeneration of central Staines. As an authority it was also important to ensure that the centre would be proficiently managed for the benefit of the local residents. The Council already had an interest in the centre so the acquisition has enabled the Council to regain control of the asset and ensure that it is managed in accordance with the Town Centre Strategy

The Elmsleigh Shopping Centre forms part of the Council's regeneration portfolio which also now includes Communication House and the Summit Centre.

Market Commentary

Office market

A commentary on the office market for the year ending March 2020 cannot ignore the huge implications on the economy of the global pandemic of Covid-19 which forced the UK into lockdown on 23rd March. Writing post quarter end, the severity of the lockdown on the UK economy cannot be understated or fully known, however for much of Q1 2020 both the occupational market and the investment market remained relatively unscathed by what was largely a crisis in China and the Far East. When the first case of Covid-19 appeared in the UK at the end of January, few people could have foreseen the national health and economic crisis that was to follow. Consequently, the quarter to March market statistics are positive with the South East office market performing well with an increase of leasing activity and supply continuing to fall.

The year started optimistically, the office market was forecasting an increase in demand, leasing activity and the continued reduction of available grade A space on the back of Boris Johnson's election victory. Total take-up in the Thames Valley Q1 totalled 267,042 sq.ft which was an increase of 21% on the previous quarter[2] although uncertainty over the direction of Brexit had seriously affected the statistics for Q4 2019. So whilst Q1 was an improvement quarter on quarter, the take-up figures were down (-24%) compared to the 5 year quarterly average. There were 28 transactions in Q1 but the average size of each transaction was 8,381 sq,ft which is also below the 5 year average of 12,500 sq.ft.[3] The Reading market reflected this trend with the majority of the deals sub 5,000 sq.ft and overall take-up, whilst positive still remained at levels below the long term averages and lower than Q1 2019[4]. Slough saw very few leasing transactions with only one significant letting above 5,000 sq.ft. either in or out of town. This was at The Future Works, close to the Porter Building where 9,500 sq.ft was let to ByBox, a serviced office operator at a headline rent of £38 per sq.ft.[5]

Take-up in the West London market which includes Hammersmith and Uxbridge totalled 135,503 sq.ft during the quarter to March. This was a decrease of 45% on Q4 2019, partly due to one large letting of 120,000 sq.ft and 26% lower than the 5 year quarterly average[6]. There were 10 significant transactions during the quarter with an average deal size of 13,550 sq.ft.[7]

Leasing activity in the South East office market had started positively in 2020 albeit still below the 5 year average. New enquiries especially in the South East market were encouraging in January and February but unsurprisingly the volume of new demand fell significantly in March. New demand across the UK office sector since mid-March has averaged 130,000 sq.ft which represents a 70% reduction of a typical week of named demand over 20,000 sq.ft. As at the end of April 10% of all UK demand had cancelled their search citing Covid-19 as the reason[8]. Demand is expected to continue to decline and it is unclear when demand levels will recover.

The level of supply across offices in the South East continued to fall during the quarter and now totals 13.08 million sq.ft, 3.05% down on the December figure. In the Thames Valley market the supply of grade A space fell a further 10.82% on the previous quarter and the level of total availability is now well below the 5 and 10 year averages[9]. The West London market saw a marginal fall in the level of available office space but not as significant as the Thames Valley market (0.4% since Q4 2019). Across the South East there are limited speculative schemes either under construction or in the pipeline. The delivery of new grade A space is expected to remain low. Covid-19 will no doubt affect the commencement of new construction projects due to uncertainty in the occupational sector and rising costs in labour and materials due to supply chain disruption and social distancing measures.

In March 2019 the research suggested that due to the low level of availability in the South East market, demand could outstrip supply in 2022/2023 leading to upward pressure on rents. This was the market prediction prior to the catastrophic impact of the Covid-19 pandemic across the world which is forecast to place the UK into a deep recession. It is too early to predict the long term effect to the property market as a result of Covid-19 beyond a fall in demand and transactions which the statistics are already indicating. It is expected that incentives to tenants will increase as landlords try to secure the limited demand in the market. Occupiers experiencing financial pressures will seek to reduce costs and release office space to the market or space will be returned through business failures. As in

[2] C&W SE Office Market Update Q1 2020
[3] C&W SE Office Market Update Q1 2020
[4] Avison Young SE Market Report Q1 2020
[5] Avison Young SE Market Report Q1 2020
[6] C&W SE Office Market Update Q1 2020
[7] C&W SE Office Market Updatae Q1 2020
[8] C&W UK Covid-19 Tracker 29/4/2020
[9] C&W SE Office Market Update Q1 2020

previous recessions the level of office availability is likely to increase but this may be of older Grade B stock rather than the new quality Grade A space at Uxbridge, Reading and Slough. Nevertheless with reduced demand and increased supply it is anticipated that rents will soften during 2020.

The period of lockdown and the enforced home-working has invoked a number of questions over the future of offices. Will working practices change permanently with more employees working from home and occupiers needing less office space? Alternatively will the need for social distancing reverse the recent trend for high occupational densities and create increased demand for office space? Businesses may look to create hubs to reduce commuting for staff that do not want to use public transport. There is some thought that serviced offices will become increasingly attractive to businesses as they offer flexible contract arrangements. At the moment it is difficult to predict what the 'new normal' will look like but there is no doubt that businesses will still require office space for their employees. Homeworking has its challenges and many people will have missed the interaction of their peers and the ability to work collaboratively in a team environment.

Retail market

Both in-town and out of town retail has been significantly challenged by the change in consumer spending away from physical stores to online retail. The emergence of the Covid-19 pandemic in the UK during February and March has placed extreme pressure on an already challenged sector. Following the government's implementation of a national lockdown on 23rd March 2020, all but essential retailers have been forced to close their physical stores which has led to an even greater short term structural shift towards online shopping.

A number of retailers have entered into administration following the enforced lockdown. In April, Debenhams called in the administrators for the second time in 12 months, and a number of retailers are in the process of trying to renegotiate rental agreements. The food and beverage sector has been particularly affected - Casual Dining Group has appointed administrators, placing at least one of its three core brands (Las Iguanas, Ed'S Diner and Slim Chickens) at risk of administration or CVA. Carluccios entered into administration in late March but has subsequently been rescued albeit with only 44% of its restaurants to be re-opened.

H&M has signed a new £862m revolving credit facility which will ease pressure after total sales fell by 46% in March 2020 against March 2019, while online sales rose by 17%. [Financial Times].

Conversely, supermarkets have seen unexpected sales growth as consumer expenditure is focused on essential purchases. In the 12 weeks to April 19, grocery sales in the UK increased by 9.1%. Year on year, sales were up 5.5% in April and 20.6% in March. The increased demand has led to expanded online and delivery slots, with Tesco adding 145,000 delivery slots during April.

In an effort to relieve the immediate pressure on (mainly) retail businesses, the government enacted a number of initiatives aimed at easing their cashflow. Firstly, retail and hospitality tenants were granted a 12 month relief period on business rates, effective from 1st April. Following that, a Business Interruption Loan was introduced followed by the Coronavirus Act 2020 in March which ensures that landlords cannot forfeit commercial leases in the event that a tenant is unable to pay its rent, service charge and other outgoings. The consequence of the latter has been that many retail tenants have refused to pay their March quarter's rent and other outgoings, which has created further uncertainty in a market where the balance has arguably shifted even further in the tenant's favour.

It is too soon to say what the impact of Covid-19 will be on an already fragile retail market. However, there will inevitably be a shift towards a turnover based rent model with landlords and tenants sharing a more balanced division of risk and reward.

Going forwards, there will inevitably be a greater focus on shopping centres being required to be seen as safe environments, the re-opening of non-essential shops on 15 June will be a an important milestone, and it will remain to be seen how town centre retail can evolve to meet the challenges.

Portfolio Activity - Investment

Letting Activity

Over the last 12 months the Council completed five lettings across the portfolio totalling 85,881sq.ft. The lettings across the Porter Building, Thames Tower and the Charter Building have increased the contracted rental income, after the expiry of rent free periods by £2,822,092 per annum. As a result of the leasing activity the portfolio void has been reduced from 14% to 8% by reference to building area.

In October, Mattel UK Ltd took a lease of the 3rd floor of the Porter Building (27,401 sq.ft) for a term of 10 years subject to a break option in the 5th year at a rent of £931,532 per annum. A capital contribution was granted in lieu of a 23 month rent free period. The Porter Building is now fully let.

In November, the Council completed two lettings of the 3rd and 4th floor at Thames Tower, Reading totalling 28,084 sq.ft. to existing tenants in the building. Fora took a new lease for a term of 19 years to be co-terminus with their other floors at a rent of £468,430 per annum. BMI Group Management Ltd entered into a new lease of the 4th floor for a term of 10 year subject to a break option paying an annual rent of £468,263.

During the last quarter, despite the uncertainty in the market due to Covid-19, terms were agreed for the letting of part 10th floor at Thames Tower, Reading. The company will take a lease of 4,900 sq.ft which will reduce the void level in the building, leaving only a small suite of sub 2,000 sq.ft. available to let. On completion of the letting, the Council will have substantially achieved the business plan objectives set at acquisition with 99% of the building let.

On 8th January a new lease was completed with Regeneron UK Limited who took 11,721 sq ft of accommodation on the 3rd floor at Charter Building, Uxbridge. The lease was for 10 years at a rent of £389,635 per annum, or £33.25 per sq ft, with a 24 month rent free period. As part of the transaction, Regeneron extended the term of their original lease in the building to be co-terminus with the new lease (c. 2 year lease extension)

Elsewhere in Charter Building, a new 10 year lease without break was completed on 6th March to Insight Direct (UK) Limited. A rent of £564,231 per annum was agreed which equates to £30.21 per sq ft on 18,675 sq ft on the 4th floor. As part of the transaction, the tenant was granted a 21 month rent free period plus a capital contribution equivalent to 21 months rent. A further £420,000 was granted as a capital contribution towards the cost of providing 70 additional car parking spaces. The tenant is obliged to pay £84,000 per annum for these spaces while they are available at the Charter Building.

On 5th March an agreement for lease was exchanged with Validity International, for a 10 year lease (subject to a fifth year tenant break) on 8,479 sq ft of accommodation on the 1st floor at Charter Building. Upon completion, the tenant will pay a rent of £271,328 per annum based upon £32 per sq ft. Rather than granting a rent free period, the Council will instead pay for the tenant's fit out, totalling c £512,000 including separation works. This equates to around 23 months rent free period. The lease is scheduled to complete in early June following practical completion of the works.

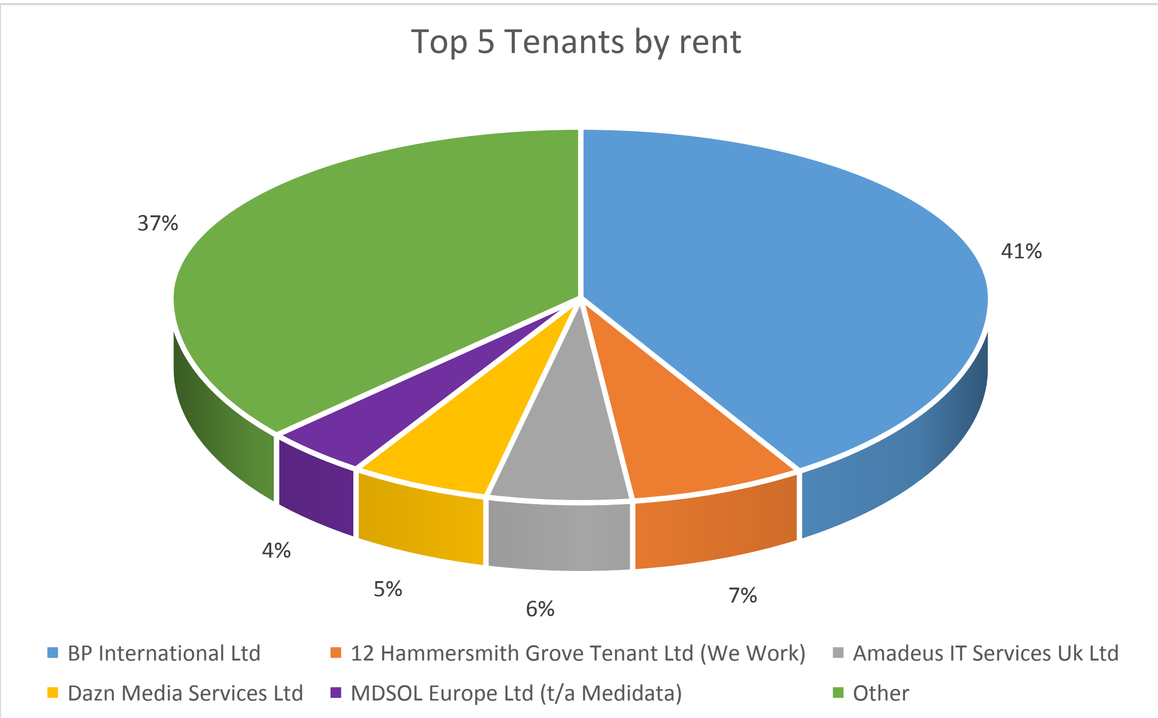
The Charter Building is now 46% let following completion of the Validity International lease.

The void rent on Thames Tower, Charter Building and Porter Building has been covered to date by rental guarantees negotiated on purchase which expire in August 2020 (Porter/Thames Tower) and August 2022 (Charter Building). By successfully completing the lettings within the guarantee period it ensures that there will only be a minimal void on expiry of the guarantee. The lettings will have a positive impact on the valuation by providing additional income certainty and removing the void costs from the valuation.

There has been no rent review activity over the last 12 months.

Rent analysis - Security of Income

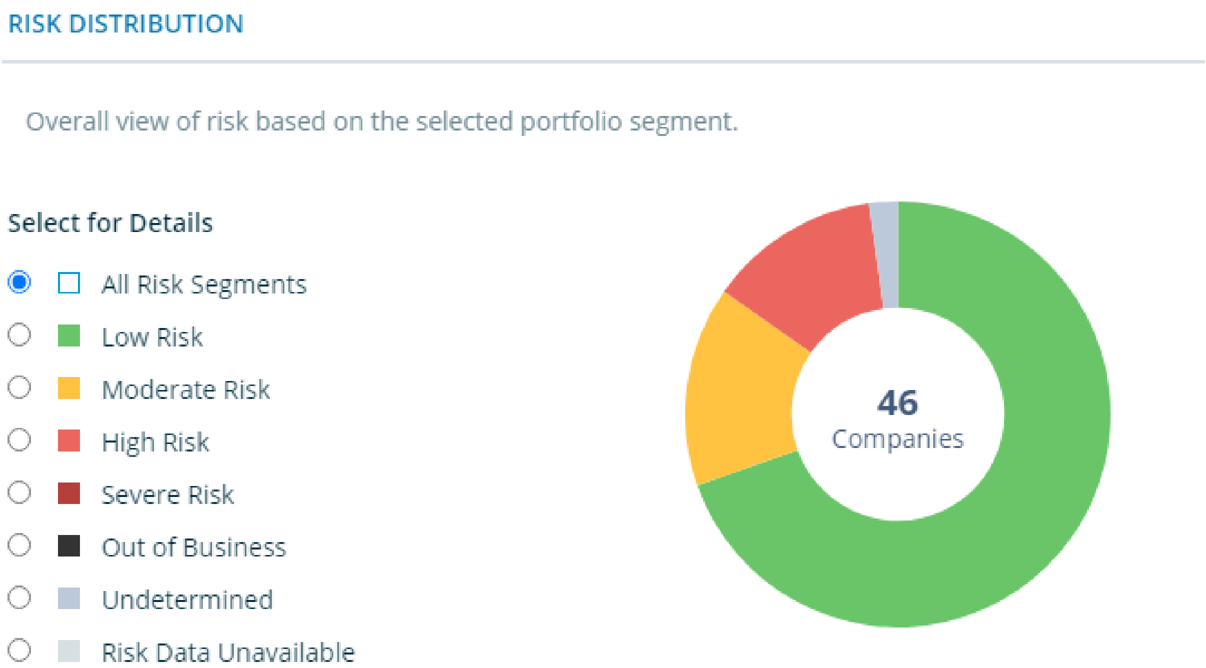
BP International Ltd remains the investment portfolio's largest tenant paying an annual rent of £17.57 million which equates to 41% of the total portfolio passing rent. This is not surprising as Sunbury Business Park remains the Council's largest asset by value at £391.73 million. WeWork, the service office provider at 12 Hammersmith Grove is the Council's second largest tenant contributing 7% to the total rent receivable followed closely by Amadeus and Perform Media. The top 5 tenants by passing rent contribute 63% of the total income.



The Fund's large exposure to BP International Ltd who has a D&B rating of 5A2 and a low risk of business failure has underpinned the exceptional rent collection performance for the March quarter.

The Council closely monitors the financial position of all our tenants and guarantors. The accountancy firm Deloitte provides advice on tenant covenant strength on acquisitions, on large transactions and provides regular financial reviews. In addition we subscribe to the Dun and Bradstreet service which monitors the financial performance of the tenants. The monitoring of all tenants is clearly important at the current time.

The rental income across the investment portfolio is supported by tenants of high financial strength as the chart below illustrates. Of the 46 companies that are monitored, 32 tenants are regarding as having a low risk of business failure, 7 have a moderate risk and 6 have a high risk of failure. According to Dun & Bradstreet only 6.52% of the overall portfolio is considered risky with both a high delinquency and failure risk. Those companies regarded as high risk fall within the serviced office sector and insurance. It is well-known that the service office sector has been a sector badly hit by the covid-19 pandemic and ongoing discussions are held with our tenants in this sector.



The overall portfolio income is reversionary with a total estimated rental value of £54.28 million. This indicates that the Council can expect future rental increases. It also provides the Council with the security that some of the properties should they become vacant ought to re-let at the same or greater rental level. There is greater risk attached to the income return of an over-rented property portfolio where there is a higher likelihood of tenant default and the inability to re-let at the passing rent.

Rent collection

The collection of the March quarters rent was a huge challenge for all landlords across all sectors. The quarter date of 25 March 2020 coincided with the Governments forced shutdown of businesses and the total restriction on movement. The economy came to a standstill and the UK was braced for a health and economic crisis of epic proportions. With no certainty as to how the pandemic will play out many tenants withheld rental payments to protect their cash position. The Council's ability to collect the rent was made harder by the Government who introduced measures to protect tenants. The Government quickly sought to pass the Coronavirus Act 2020 which prohibited the use of forfeiture as a means to collect the rent until 30 June. This was extended further on 23 April preventing the landlord from serving notice and then instructing an Enforcement Agent to seize and sell goods to meet the outstanding rent (a process known as CRAR). The Taking Control of Goods and Certification of Enforcement Agents (Amendment) (Coronavirus) Regulations 2020 meant that the rent had to be 90 days in arrears rather than the previous 7 days before action can be taken to recover the sums. The Government also announced a temporary ban on statutory demands and winding up petitions where the tenant cannot pay its rent for Covid-19 reasons. The practicalities of serving a notice correctly on the tenant and getting a date for a court hearing also make the process of statutory demands and winding up petitions a pointless exercise for the landlord to coerce the tenant into paying the rent. Essentially the Government made it clear that tenants would be protected from any aggressive action to recover the rent by Landlords.

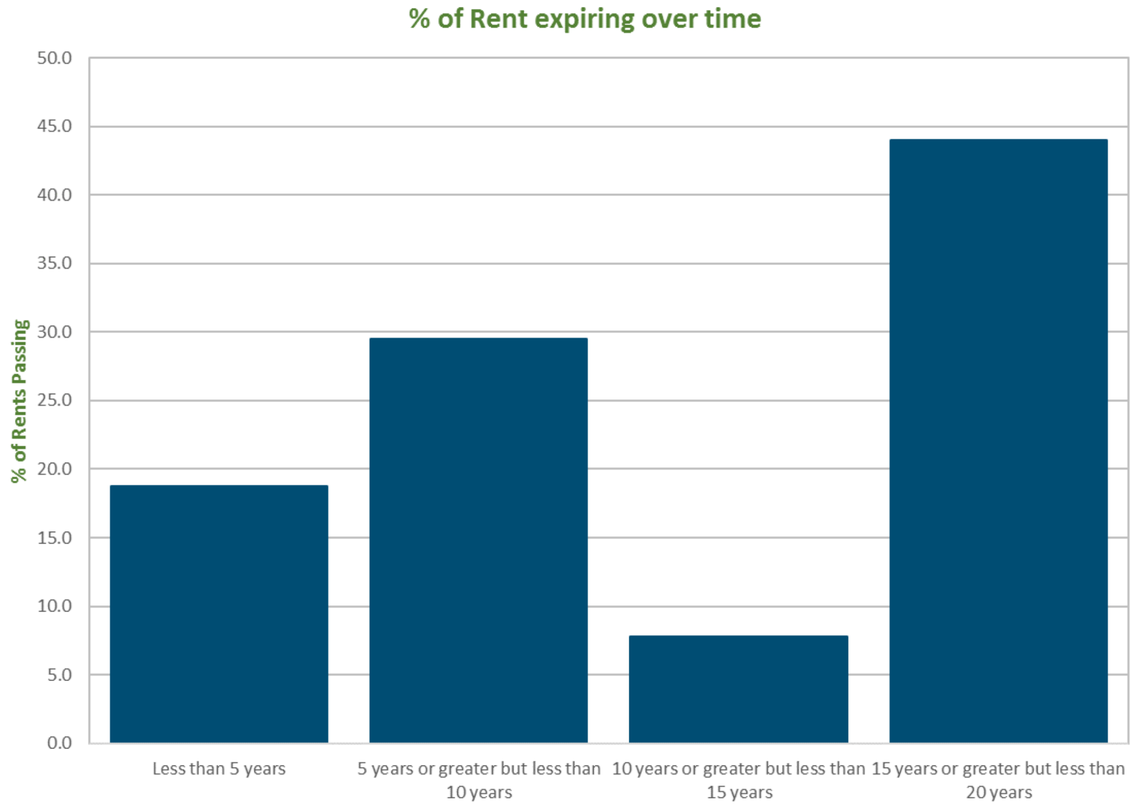
Despite these restriction by the 31st March 2020 the investment portfolio collection rate was 79% and by 14th May 2020, 90% of the portfolio rent had been collected (excludes the Elmsleigh Centre). This compares favourably to other landlords; research published by Re-Leased which collated data from 10,000 properties and 35,000 leases indicated that on average 49.7% of all UK rent had been collected 10 days after the March quarter. This was a decline from 69.7% on the average collection rates for the last two years. As you would expect the office sector was more resilient with on average just over 60% collected[10].

With limited recourse to legal remedies to collect the rent the Council has adopted a policy of engaging and negotiating with tenants on an individual basis to identify their particular financial position. Where appropriate, monthly payments and rent deferments have been agreed. Rent collection has been given top priority and weekly meetings are held with the Leader, Portfolio Holders, Councillors, the CEO and other senior officers. Any rent concession proposal that is considered is modelled to examine the impact it will have to the Council's sinking fund over the next 5 and 10 years.

Longevity of Income

The portfolio is positioned well in terms of longevity of rental income with 51.8% of the current annual income secured for 10 years or more. Of this figure, 44% is secured for more than 15 years. This is an increase on March 2019 when 45% of the current annual income was secured for 10 years or more with 37% more than 15 years. WeWork and BP International, the Council largest tenant by rent payable contributes to this total with leases in excess of 15 years. The long term secure income of 20 years plus provided by the Council's freehold interest in the Elmsleigh Centre is no longer accounted for in the Investment portfolio following the acquisition. The lettings completed over the quarter will have improved the longevity of income at the Charter Building.

[10] Property News UK, 24th April 2020



The proportion of short term income, expiring in 5 years or less is 18.7% of the total annual rent. This has decreased since December (33.4%) due to the creation of a dedicated regeneration portfolio which now includes Communications House, the Summit Centre and the Elmsleigh Shopping Centre. The successful negotiation to remove the break option with Volga-Dnepr at Stockley Park due in January 2021 has also had a positive impact. The rental guarantees on the vacant space at the Charter Building account for a large percentage of the short term income expiring in August 2022. The completion of the lettings at the Charter Building and the on ongoing leasing activity will greatly improve the income profile and reduce the Council's exposure to short term income.

Portfolio Activity – Regeneration Portfolio

Letting activity

There have been three lettings on the Regeneration portfolio during Q1 2020, producing £850,000 per annum in secured rent.

At Units 3&4 The Summit Centre, Sunbury, two reversionary leases to ADT Fire & Security plc were completed on 28th February on accommodation totalling 56,412 sq ft. The leases are for five years and take effect from 4th August 2020, at a total rent of £850,000 per annum. The lease on Unit 4 is subject to a third year tenant break option. These leases were agreed on a non-binding basis at the time of the asset acquisition in September 2019, and underpin the core income for the property over the next five years while redevelopment plans are progressed.

On 9th March, the Council agreed a new letting to Topman/Topshop on Units 15/16 Elmsleigh Centre, after the tenant served notice to vacate on 14th March. This was a short term letting with the tenant paying only rates for a period of two years subject to a rolling mutual break option on 15th August on no less than eight weeks notice. In light of the government lockdown two weeks later, this was a timely letting that partially defrays the Council's outgoings.

During Q1 2020 there were a number of lease negotiations with occupiers at the Elmsleigh Centre, including H Samuel, Ernest Jones, Body Shop and Clinton Cards. Given the evolving position with Covid-19, it has proved challenging to finalise these lettings given retailer sentiment, but it is hoped that there will be greater activity over the next two quarters.

Asset Management

Elmsleigh Centre

The Elmsleigh Centre was acquired as a regeneration opportunity and therefore sits the Regeneration Portfolio. During the acquisition, an asset management business plan was created which considered short, medium and long term potential development opportunities. Cabinet approval was also obtained at the time for specific enhancement projects including:-

- Car parking consolidation and refurbishment
- Branding, wayfinding and modernising
- Transformation of the southern entrance and the creation of a public square
- Conversion of vacant accommodation above Decathlon into office/gym/nursery

The business plan for the acquisition investigated the potential for development and housing delivery within the town centre, on a phased basis and geared around key lease expiries/lease events from major tenants such as Primark, Matalan etc.

In forming the business plan consideration was given to the fact that the North Mall is the more valuable and vibrant section of the Centre, with the pitch falling away within the East Mall and South Mall areas. The business plan also factors in a reduced need for retail within the town centre over the next decade, which provides an opportunity to re-purpose the less valuable South and East Malls into residential while retaining a reduced retail offer within the North Mall close to the High Street.

Following purchase of the Centre in early February, the Council has now appointed Collado Collins (in line with the report to Cabinet on the original acquisition) to progress initial scheme designs for certain elements of the Elmsleigh Centre. This work is progressing in tandem with the wider Staines town centre masterplan which is being developed through David Locke Associates which will provide evidence around our housing delivery programme as part and parcel of the revised Local Plan.

Communications House

Communications House was acquired in 2018 as a strategic development opportunity in the town centre. The building is fully let to five tenants and produces an income of £1,246,447 per annum with varying lease expiries between 2021 and Q1 2023. It forms a significant land holding which complements the adjoining ownerships at Thameside House and the Elmsleigh Centre. The intention is to redevelop into a residential led scheme once vacant possession can be obtained.

The priority over the last 12 months has been to retain the principal tenant, Samsung R&D, which accounts for the majority of the income (£970,000 per annum) and whose lease expires in Q3 2021.

The Summit Centre, Sunbury

The Summit Centre was acquired in September 2019 to provide core income with medium term regeneration and development opportuties in a strategic location next to the M3/A316 junction at Sunbury Cross.

Following completion of the reversionary leases to ADT Fire & Security this quarter (see above), the Council can now look towards wider land assembly to unlock medium term development.

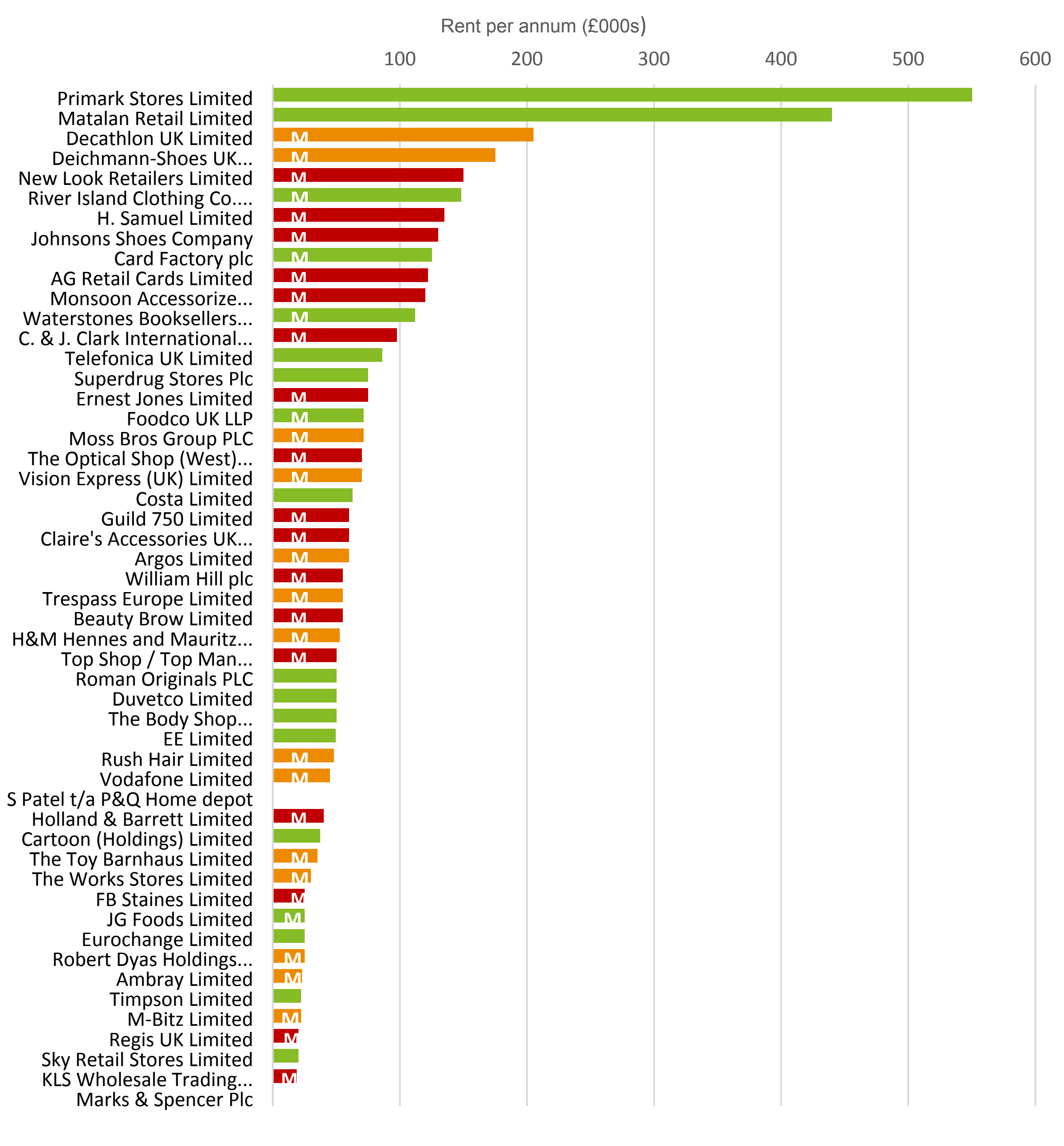
During the quarter we had one tenant entering into liquidation at Unit 1f Summit Centre. The tenant, The Old Surrey Window Company, was paying a rent of £15,000 per annum. A rent deposit was held which covered the Council for the December quarter's rent plus VAT. Following the liquidation we have commenced marketing and at the date of this report, we are close to agreeing terms with a new tenant.

The tenant of 33 Hanworth Road, Cyntergy Limited, also entered administration on 20th March 2020. We are in discussions with the guarantor on the lease, Omnico Holdings Limited, to step in and pay the March quarters rent and to agree a lease surrender in advance of the December 2020 expiry. This is on the basis of agreeing terms with another occupier/s to take a lease on the building, and progress is being made in that regard. It is anticipated that the ground floor accommodation will be let to the Incubator project which is an initiative which will be led by the Council's Economic Development team.

Rent analysis - Security of Income

This section focuses on the Elmsleigh Centre only. The table below shows a summary of the tenant risk profile at the Elmsleigh Centre, based on a Red/Amber/Green ("RAG") rating which includes a number of factors, including credit score, gearing, operating margins, changes in sales and operating margins and net assets.

Tenant RAG Analysis Ranked by Income. Source:Deloitte

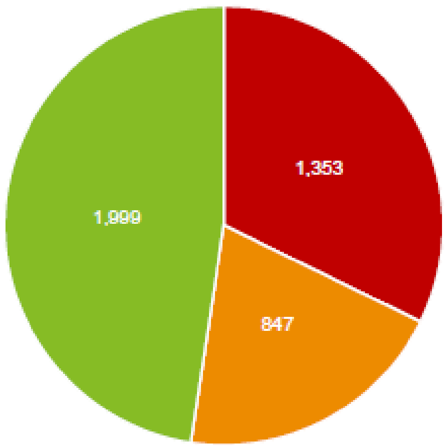


The top ten entities by rental value total £2.2m per annum which is 54% of the rental income of the shopping centre. Of these ten occupiers, there are four entities considered low risk, two entities rated moderate risk and four entities that are viewed as high risk. Two of the top ten tenants have been through an insolvency / CVA process.

The top tenant by income at the Elmsleigh Centre is Primark Stores Limited which accounts for 13% of the overall gross income. This is followed by Matalan Retail Limited which pays 10.4%. Both of these are viewed as low risk tenants according to a report commissioned by Deloitte at the time of purchase.

The overall rent can be categorised in risk terms as follows:-

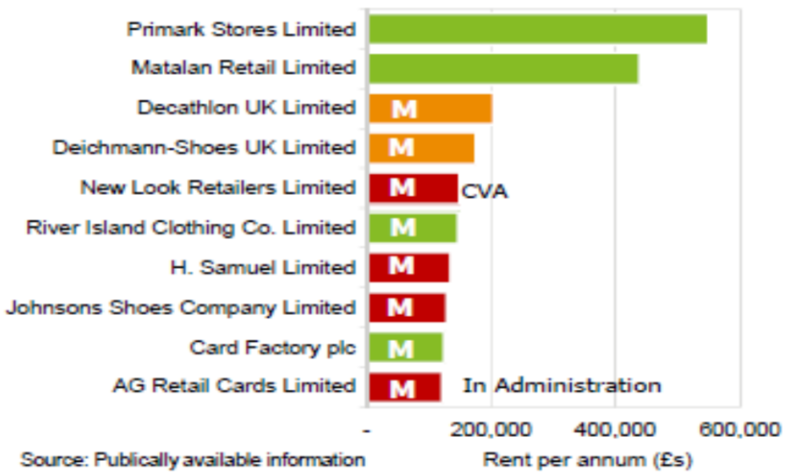
Rent per annum (£'000s)



Source: Management information

The Deloitte report rates the top 10 tenants into the following RAG categories:-

Top ten by rent



Source: Publically available information

The top ten high risk entities total £1.08m of rental value which accounts for 25.5% of the overall rental income for the centre. These tenants are closely monitored with regular financial updates obtained via Dun & Bradstreet.

Rent Collection

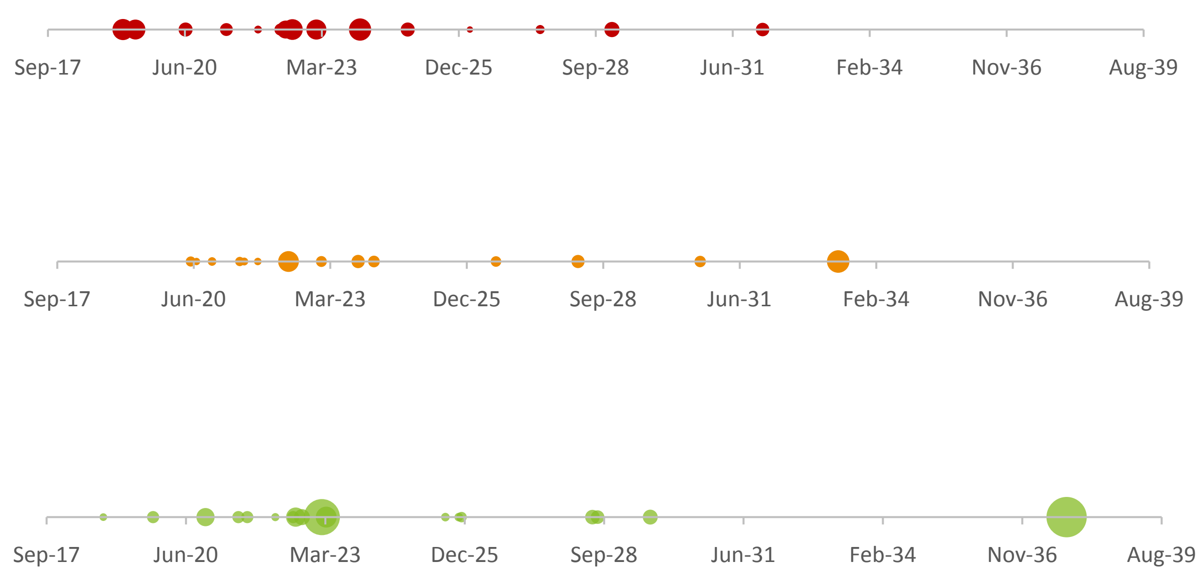
As highlighted earlier government intervention coupled with the lockdown on 23rd March has created significant challenges in collecting rent on retail properties in particular. At the date of this report, the March quarter rent and service charge collection statistics on Elmsleigh Centre stood at 18.06% and 61.13% respectively (30.78% combined).

While these figures are concerning, they are representative of the wider retail sector, and major retail landlords such as Hammerson, Intu and Land Securities have reported similar statistics. The Assets team has adapted its strategy towards rent collection and approximately 75% of time spent during end March / April was dedicated to chasing rent and service charge payments in collaboration with our managing agents.

Longevity of Income

At the Elmsleigh Centre, 35 tenant leases are due to expire before 2023, which totals 41.6% of the rental value. Primark has a lease until 2037 and contributes 13% of the overall rent, whereas Matalan (10.4% of rent) has a lease due to expire in 2023.

The following chart shows an illustration of financial risk by mapping the various lease expiries and breaks at Elmsleigh Centre against the quantum of rent (bubble size). There is a clear consolidation of lease expiry/break events around 2023 which is the focus of short term asset management.



Source: Deloitte

Asset Profile

PROPERTY ADDRESS: BP Campus, Sunbury Business Park, Sunbury

Asset Details

Sector: Office/Business Park	**Tenure:** Freehold	**Independent Valuation:** £391.73 million (31st March 2020)	**Purchase Price:** £384.9 million (December 2016)
Property Description:	The main site is arranged as a campus style development comprising of eight buildings constructed between 2000 and 2014. They are of steel framed construction with glazed and aluminium cladding under a flat roof. They are fitted out as offices with a Grade A specification although some of the accommodation includes laboratories and a lecture hall. The SW corner site comprises of 4 buildings dating from the 1950's to 2000. The offices, laboratories and warehouse are of a basic internal specification in line with the age of the property. There are 2,001 car parking spaces.		
Total Area: 701,659 sq.ft	**Passing rent:** £17.57 million pa	**ERV:** £19.90 million pa	**Vacancy %** 0%
Key Tenant: BP International Ltd			

Asset Strategy

Summary Strategy	To hold the property with a view to progressing the rent reviews in September 2021. The property is reversionary and the Council should benefit from a substantial uplift in income.

Asset Profile

PROPERTY ADDRESS: 12 Hammersmith Grove, Hammersmith, London

Asset Details

Sector: Office	**Tenure:** Long Leasehold	**Independent Valuation:** £165.9 million (31st March 2020)	**Purchase Price:** £170 million (January 2018)
Property Description:	The property is located in a prime position in Hammersmith, next to the entrance to Hammersmith Underground station and within easy access to the A4/M4 corridor and Heathrow. The Landmark building was completed in February 2016. The multi-let office building provides Grade A accommodation over ground and ten upper floors.		
Total Area: 170,011 sq.ft	**Passing rent:** £9.54 million pa	**ERV:** £9.44 million pa	**Vacancy %:** 0%
Key Tenants: We Work Hammersmith, Perform Media Services, Creative Arts Agency, Medidata Europe Ltd, Research Instruments ltd and All Nippon Airways Co Ltd.			

Asset Strategy

Summary Strategy	To hold the property to benefit from the rental growth anticipated at the first rent review in 2022/2023. Good longevity of income should provide good prospects for capital value growth in the medium term.

Asset Profile

PROPERTY ADDRESS: 3 Roundwood Avenue, Stockley Park.

Asset Details

Sector: Office/Business Park	**Tenure:** Freehold	**Independent Valuation:** £20.10 million (31st March 2020)	**Purchase Price:** £21.40 million (July 2017)
Property Description:	Stockley Park is a well-established business park located near Uxbridge with excellent transport connections to J4 of the M4, M25, Heathrow Airport and Central London via Hayes and Harlington Rail Station, Uxbridge Underground station and soon Crossrail. The property was built in 1990 and was comprehensively refurbished in 2014 and 2016. It is a two storey, steel-framed building with glazed atrium reception and WC's and shower facilities on both ground and first floor. The refurbished office space provides 4 pipe fan coil air conditioning, LED lighting, raised floors, metal tiled suspended ceiling. A car park provides 136 car parking spaces, a ratio of 3.17 spaces per 1,000sq.ft.		
Total Area: 42,907 sq.ft	**Passing rent:** £1.43 million pa	**ERV:** £1.50 million pa	**Vacancy %:** 0%
Key Tenants: Verifone (UK) Ltd, Volga DNEPR (UK) Ltd			

Asset Strategy

Summary Strategy	To hold the property in anticipation of rental growth following the potential longer term expansion of Heathrow airport and the opening of Crossrail. To ensure we retain the existing tenants to reduce the risk posed by the tenant's exercising the break options in 2021/2022.

Asset Profile

PROPERTY ADDRESS: World Business Centre 4, Newall Road, Heathrow Airport

Asset Details

Sector: Office	**Tenure:** Part freehold & part leasehold	**Independent Valuation:** £45.80 million (31st March 2020)	**Purchase Price:** £47.248 million (September 2017)
Property Description:	Located to the north of Heathrow airport it is a stand-alone office building adjacent to World Business Centre 1, 2 & 3. Recently completed it is of steel frame construction with glass elevations and a flat roof. It provides open plan, Grade A accommodation over ground and three upper floors. There is an underground car park providing a car parking ratio of 1:556sq.ft.		
Total Area: 89,282 sq.ft	**Passing rent:** £2.46 million pa	**ERV:** £2.37 million pa	**Vacancy %:** 0%
Key Tenant: Amadeus IT Services UK Ltd			

Asset Strategy

Summary Strategy	Long term hold to benefit from the 15 year income return. Asset well placed to withstand market movement due to grade A building, close proximity to Heathrow and long lease to a tenant of substantial financial strength.

Asset Profile

PROPERTY ADDRESS: Elmbrook House, 18-19 Station Road, Sunbury-on-Thames.

Asset Details

Sector: Office	**Tenure:** Freehold	**Independent Valuation:** £7.24 million (31st March 2020)	**Purchase Price:** £7.160 million (December 2016)
Property Description:	The property was constructed in the mid 1990's and comprehensively refurbished in 2016. It is three storey concrete framed structure with brick elevations and hipped slate covered roof. The property provides office accommodation over ground with three upper floors.		
Total Area: 19,480 sq.ft	**Passing rent:** £0.478 million pa	**ERV:** £0.487 million pa	**Vacancy %:** 0%
Key Tenant: Complete Cover Group Ltd			

Asset Strategy

Summary Strategy	The property provides a good income for a further 6 years. It provide flexible office space in a regional market and compares favourably to other office accommodation in the area in terms of parking and transport connections. It benefits from planning consent for a change of use from offices to residential apartments. The medium-term strategy is to consider a residential redevelopment when the lease expires in 2026.

Asset Profile

PROPERTY ADDRESS: Charter Building, Uxbridge

Asset Details

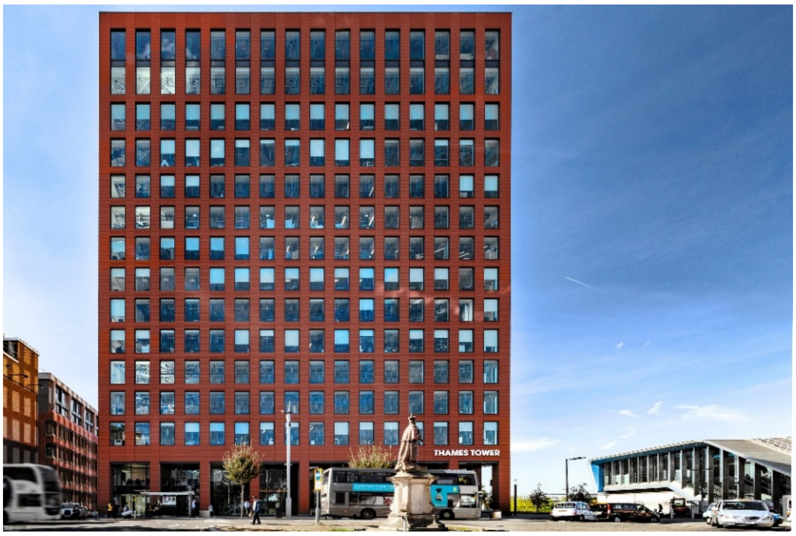
Sector: Office	**Tenure:** Freehold	**Independent Valuation:** £131.20 million (31st March 2020)	**Purchase Price:** £135.98 million (August 2018)
Property Description:	The property is located in Uxbridge town centre within close proximity to the train station. Newly completed in 2017 by Brockton Capital and Landid it provides Grade A office accommodation over lower ground and five upper floors. The building benefits from a large reception area and five storey atrium, decked roof terraces and 326 car parking spaces. The open plan floorplates provide flexible space that range in size from 8,747 sq.ft to 54,076 sq.ft .		
Total Area: 235,458 sq.ft	**Passing rent:** £2.69 million pa (excludes guarantees)	**ERV:** £7.41 million pa	**Vacancy (as % of floor area):** 54%
Key Tenants: Spaces, Tracelink, Parkview, Jazz Networks, Regeneron, Café Kix.			

Asset Strategy

Summary Strategy	To the let the vacant space at or above ERV within the timeframe provided by the guarantees to avoid full vacancy costs.

Asset Profile

PROPERTY ADDRESS: Thames Tower, Reading



Asset Details

Sector: Office	**Tenure:** Freehold	**Independent Valuation:** £126.8 million (31st March 2020)	**Purchase Price:** £119.32 million (August 2018)
Property Description:	The building was developed by Brockton Capital & Landid and completed in 2017. It is prominently located in Reading town centre adjacent to Reading train station. It provides Grade A office accommodation over basement, ground and 14 upper floors. A private occupier terrace and café is provided on the 14th floor.		
Total Area: 190,868 sq.ft	**Passing rent:** £6.18 million pa (excludes guarantees)	**ERV:** £6.69 million pa	**Vacancy (as % of floor area):** 3.5%
Key Tenants: Fora, Pret a Manger, Clarkslegal, Make a Wish, Broadway Malyan, HSBC, MBNL, Eriksson, BDO, Austin Fraser, Objective Corporation.			

Asset Strategy

Summary Strategy	To let the vacant part 10th floor at or above ERV within the timeframe provided by the guarantees to avoid full vacancy costs. To improve the income profile when opportunities arise by negotiating longer leases, removing break options or improving the covenant strength. Long term hold to benefit from expected reversionary potential in 2022/2023.

Asset Profile

PROPERTY ADDRESS: The Porter Building, Slough

Asset Details

Sector: Office	**Tenure:** Freehold	**Independent Valuation:** £69.90 million (31st March 2020)	**Purchase Price:** £66.47 million (August 2018)
Property Description:	The building was developed by Brockton Capital & Landid and completed in 2017. It is located in a prominent position in Slough town centre opposite the station. It provides high quality Grade A office accommodation over ground and four upper floors.		
Total Area: 117,388 sq.ft	**Passing rent:** £3.94 million pa	**ERV:** £3.88 million pa	**Vacancy (as % of floor area):** 0%
Key Tenants: Starbucks, Fiserv, Spaces & Orange Business Services			

Asset Strategy

Summary Strategy	Long term hold to benefit from anticipated rental growth in 2022/2023 and any capital growth from positive yield movement.

Asset Profile

PROPERTY ADDRESS: Elmsleigh Shopping Centre, Staines

Asset Details

Sector: Retail	**Tenure:** Freehold	**Independent Valuation:** £39.325 million **NB** although the asset was not formally valued pre-purchase, independent property consultants JLL supported the purchase price.	**Purchase Price:** £39.325 million (February 2020)
Property Description:	The Elmsleigh Shopping Centre is a modern, covered shopping mall fronting the High Street and with access at the rear to Friends Walk and bus station. Adjoining the Centre is a multi-storey car park. The freehold was purchased by Spelthorne in February 2020. The acquisition also included the purchase of the Titles to:- 1-6 Friends Walk, 77 High Street, 91-93 High Street, 101-103 High Street (rear only), the Elmsleigh and Tothill multi-storey car parks, and Elmsleigh shopping centre itself. The shopping centre and adjacent premises currently present 51 separate retailers plus additional mall kiosks*		
Internal Lettable Area 200,977 sq.ft	**Passing rent:** £4.36 million pa	**ERV:** £3.72 million pa	**Vacancy %:** 3.2551%
*** Key Tenants:** Deichmann, Matalan, Decathlon, Primark, M&S, H&M, New Look, and others			

Asset Strategy

Summary Strategy	A strategic long-term regeneration investment for the Council, Elmsleigh Centre is also a focal point at the heart of the community. An opportunity to maximise potential on multiple levels – housing, work, communications, community, leisure, retail – it is key to the prosperity of Staines. The Council is committed to promote and improve Staines as a thriving centre.

Asset Profile

PROPERTY ADDRESS: Communications House, South Street, Staines

Asset Details

Sector: Office	**Tenure:** Freehold	**Independent Valuation:** £14.50million (March 2020)	**Purchase Price:** £11.70 million (July 2018)
Property Description:	The property is located in Staines town centre adjacent to the Tothill car park and the Elmsleigh Centre. Constructed in 1981 and refurbished internally in 2013 it provides office accommodation over ground and five upper floors. The building is an 'L' shaped, brick construction with a flat roof.		
Total Area: 47,500sq.ft	**Passing rent:** £1.25 million pa	**ERV:** £1.25 million pa	**Vacancy rate:** 0%
Key Tenant: Samsung Electronics (UK) Ltd, Pros Europe Ltd, Anglo Gold Ashanti Holdings Plc, Marsh Corporate Services Ltd, Mathison & Macara LLP.			

Asset Strategy

Summary Strategy	To maximise the income in the short term. In the medium term there is the potential to redevelop the site in conjunction with other property assets owned by the Council nearby such as Tothill Car park.

Asset Profile

PROPERTY ADDRESS: The Summit Centre, Sunbury

Asset Details

Sector: Light Industrial/Office	**Tenure:** Freehold	**Independent Valuation:** £13.50 million (31st March 2020).	**Purchase Price:** £13.79 million (September 2019)
Property Description:	The site of 4.47 acres includes a mix of industrial and office accommodation constructed during the 1970's and 1980's. Units 3 & 4 provide a 2 a storey office and R&D space over 56,412 sq.ft. 33 Hanworth Road provides 1970's style office accommodation with a warehouse to the rear totalling 10,627 sq.ft. There is a terrace of 6, small industrial units ranging in size from 997 to 1,196 sq.ft.		
Total Area: 73,401 sq.ft	**Passing rent:** £1.03 million pa	**ERV:** £1.12 million pa	**Vacancy (as % of floor area):** 0%
Key Tenants: Johnson Controls/ADT Fire and Security plc, Cyntergy Ltd.			

Asset Strategy

Summary Strategy	To maintain short/medium term income by renewing leases if possible or re-letting. The longer term strategy is to redevelop the site for residential. To create a larger site for redevelopment the Council is considering acquiring other sites/buildings to maximise the potential.

Glossary

Capital Growth - The increase in value of the property over time also known as capital appreciation. It can be calculated with reference to the previous valuation or since purchase.

Capital Return – In the context of the report this is the capital value growth shows the capital appreciation since the date of purchase.

Capital Value - This is also known as the property's market value. The market value is defined by the International Valuation Standards Council 'IVSC' and the Royal Institution of Chartered Surveyors to mean 'the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The IVSC makes it clear that a "willing seller" is simply a seller motivated to sell at the best price obtainable on the valuation date.

Estimated Rental Value (ERV) - The estimated annual rent that would be achieved if the floor space was to be re-let in the open market at the valuation date. The rental value is determined by Carter Jonas, the Council's appointed valuers.

Equivalent yield - The internal rate of return of the cashflow from the property, assuming a rise to ERV (estimated rental value) at the next review but with no further rental growth.

Grade A – This refers to the quality of the office space. A Grade A building is the highest quality of building, it is typically newly constructed or substantially redeveloped. It is considered the best in class in terms of aesthetics, standard of finishes, state of the art systems and location.

Gross/Net Rental Income – the actual rent received or receivable either including or excluding revenue costs such as marketing costs, letting fees, void costs.

Income Yield/Net Initial yield – The annual passing rent less costs as a percentage of the capital value, after adding notional purchaser's costs. In the report the income yield has been calculated at the valuation date.

Investment cover – the ratio of net income received by the Council to the total payable in loan repayments and interest in the financial year.

Lot size – the capital value of the property.

Net Asset Value – the full value of all the properties owned by Spelthorne Borough Council.

Passing rent – the contracted rent or gross rent less any ground rent payable under the lease over a 12 month period.

Quarter Day – the dates specified under the lease when the rents are payable. The English quarter days are 25th March, 24th June, 29th September and 25th December.

Rent free period – a period of time during the lease when the tenant does not have to pay rent. Typically granted to a tenant as an incentive to enter in to a lease.

Reversionary Lease – a lease which is granted today but has a future term commencement date. They are granted to extend a tenant's lease.

Vacancy rate – the amount of space within a property which is currently empty and not generating rent as a percentage of the whole property or portfolio. The rate can be expressed a percentage of floor area or as a percentage of the estimated rental value.

Void – a period when the property is vacant and is not generating any rent.