

Insight:

Local authorities – navigating the real estate challenges



With the ever-increasing number of local authorities highlighting the issues and pressures they face on balancing their books, we look at one area that has impacted them over the last few years – real estate.

Investing in real estate in their local area should not be seen as purely financial as it offers many other benefits to the communities they serve. However, in the years before Covid, many local authorities expanded beyond their locality with the availability of almost free money, from the Public Works Loan Board, allowing them to chase yield and income to try to balance their books in a time of austerity. Extreme examples of this include Thurrock investing in solar farms and Spelthorne investing outside the borough's boundaries.

Through Covid and beyond, there has been the perfect storm of reduced rents and values alongside increased costs and interest rates.

Local authorities need to address these issues and look at the potential solutions and opportunities. We discuss these below, along with the different skill sets they may need to consider to move forward.

We see several key issues affecting local authorities' real estate portfolios

Unbalanced property portfolios under pressure

- Large exposure to shopping centres and secondary offices
- Many purchased at the top of the market
- Inexperienced property teams

Loan to value tension

- Preferential borrowing resulted in spending sprees on risky investments
- Value depletion in office and retail worse affected
- Hard to see a short-term correction

Cash flow concerns

- Once steady income streams have now become volatile
- Voids increase the Landlord's liabilities
- Energy costs will have significantly impacted void cost exposure

ESG impact on portfolios

- Number of properties will be sub-standard in terms of EPC

- Increased requirement on capex to turnaround the investment
- Expensive void periods whilst ESG remedies are sought

Transactional troubles

- Asset classes by nature are relatively illiquid
- Large assets have dropped in value
- Cannot fire sale to cut losses

But there are opportunities and solutions to solve these issues

Operational

- Employ a wider skill base to work assets (compliment with external appointments)
- Apply a restructuring mindset without political limitations
- Seek more commercial goal driven KPIs for teams to encourage innovation

Financial

- Seek JV partners who are looking for minimum risk partners
- Combine with other local authorities to become bigger players
- Restructuring opportunities for 'non-performing loans'

And it may need a different skill set to deliver these solutions

The solution may be to look at corporate restructuring as a template. With an understanding of the pressures on staff and working alongside the relevant management boards, some or all of the following skills may be required:

- Chief Restructuring Officer
- Stakeholder management and communications
- Debt restructuring
- Asset and property management
- Property redevelopment and repurposing
- Cash flow management and financial control



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