The Rt Hon Thérèse Coffey MP
Secretary of State for Environment, Food and Rural Affairs
Seacole Building
2 Marsham Street
London
SW1P 4DF

25th January 2023

Dear Secretary of State,

**CANAL & RIVER TRUST: REPORT OF THE PROTECTOR**

## Introduction

The Grant Agreement ("the Agreement") dated 28th June 2012 made between The Secretary of State for Environment, Food and Rural Affairs ("Defra") and Canal & River Trust ("CRT" or "the Trust") provides that the parties shall appoint jointly a person as the Protector of the Protected Assets. The Protected Assets comprise the Investment Assets (principally property held for investment purposes) and the Protected Operational Assets as defined in the Agreement.

I have been appointed as the Protector and this is my ninth formal report to Defra, covering CRT's Financial Year ended 31st March 2022.

## The role of the Protector

The role and duties of the Protector are defined in the Agreement. The key requirement is that the Protector shall monitor compliance by CRT with the provisions of Schedule 8 of the Agreement to ensure there is no Material Diminution or Material Diversion. The role includes receiving CRT's Annual Investment Plan ("AIP") and any review or revision by CRT of the Group Investment Policy ("GIP"). Under the Agreement the Protector is required to give feedback and comments to CRT on the AIP and GIP, as appropriate.

The Agreement entitles the Protector to receive Minutes of meetings and other reports and information as may be reasonably required in order to fulfil the role.

There is a mechanism for the Protector to issue warnings in the event of threatened or actual Material Diminution or Material Diversion, and a Non-compliance Notice following a failure to sufficiently satisfy conditions relating the implementation of a plan to address concerns raised by the Protector.

Lastly, the Protector is required to report annually to Defra on the management of the Investment Assets by reference to performance against the objectives of the GIP.

## Process

During the course of the year, I liaised with Officers of CRT and in the capacity of observer, I attended meetings of CRT's Investment Committee. I have also been provided with various Minutes, reports and other information, including the annual property valuation (as at 31st March 2022) prepared by CRT's External Valuer, Avison Young.

I have also had sight of the investment performance report relating to the majority of the properties held for investment purposes prepared by MSCI, the Trustees' Annual Report and Accounts 2021/22, and the Pro Forma Accounts for the Canal & River Trust Protected Asset Fund, for the year ended 31st March 2022.

I have reviewed the documents referred to above and where necessary sought clarification or further information. I have also informally discussed the tone of the property valuation with Avison Young and received from Partners Capital LLP ("Partners") confirmation that the means by which the value of the investments managed by them is assessed (and from which the investment performance of those assets is partly derived) has not changed from the prior year.

As required by the Agreement I have provided feedback and comments to CRT where I considered it appropriate to do so.

My opinions and conclusions are of course reliant upon the completeness and accuracy of the information with which I have been provided, but I am not aware of any material omissions or areas of concern.

## Principal Findings

1.0 During the year CRT managed the Investment Assets by reference to the GIP dated March 2013 (with subsequent revisions). The GIP sets out various operating principles and the means by which the policy will be implemented. Key items include:

- 1.1 To maximise the total returns (income and capital gain) of the Investment Assets without taking undue risk over the medium to long term.
- 1.2 To preserve and grow the value of the Investment Assets in real terms.
- 1.3 Not to use the Investment Assets, nor investment proceeds, in any manner that is inconsistent with CRT's objects.
- 1.4 To manage risk and liquidity in a manner consistent with the investment objectives and the needs of CRT in meeting its' obligations under the terms of the Agreement.

2.0 During the year in question there were no changes proposed or made to the GIP.

3.0 In the 12 months to end-March 2022 the total value of the Protected Endowment Net Assets (excluding the pension fund asset/liability) rose from £907.4m to £987.7m; an increase of £80.3m (+8.9%). (See attachment: Protected Asset Fund Consolidated Balance Sheet.)

4.0 During the year, CRT sold 25 investment properties for a total consideration of ca. £23m. In aggregate these properties achieved a price some 44.5% above their combined value at the start of the period (equivalent to +24.4% after costs).

5.0 As at March 2022 the Investment Assets included 271 properties (excluding boating properties), of which the top 100 accounted for about 92% of the total property value.

6.0 Void properties (ie, those which are not income producing) accounted for ca. 7% of the total estimated rental value of the property investment portfolio. This figure excludes assets that are not intended to be let in their current condition; for example, properties held for development. For comparison purposes the void rate in the MSCI UK Quarterly Property Index was 7.9%.

7.0 Those property investment assets that are measured by MSCI produced a total return (income plus capital appreciation) of 10.5%. This figure reflected an income yield of 4.3% and capital appreciation of 6%. The market return, as represented by the MSCI UK Quarterly Property Index, was 19.6% for the 12 months to end-March 2022. Although this is the first time that I have reported underperformance relative to the Index, the Trust's property assets have still outperformed the Index over 3, 5 and 10 year periods. Inflation, as measured by the Retail Prices Index (RPI), during the same period stood at 9% (inflation as measured by CPI was 7% over the 12 months to March 2021).

8.0 The Trust's property investments therefore delivered a positive total return, albeit below the MSCI benchmark. Much of the relative underperformance was due to the Trust's holding in Ground Rents, which underperformed the Index average, and the lower exposure to industrial property, which had a particularly strong year in performance terms.

9.0 During the Financial Year the non-property investment assets managed by Partners Capital produced a return of ca. 14.9% (in GBP and net of fees) and the value of the fund stood at £290.9m (including new money invested during the year). This was ahead of the SAA Composite Benchmark (9.5% excluding FX adjustments), and since inception the total return from the non-property investments remains slightly ahead of this benchmark (9.0% vs 8.1%).

10.0 As noted in previous reports, some of the underlying investments managed by Partners Capital may not be as liquid as, for example, publicly traded securities or commercial property, therefore the degree of confidence with which they can be ascribed a market value may be lower.

11.0 During the year ended 31st March 2022 investment sentiment rallied and markets posted generally positive returns as the impact of the Covid-19 pandemic and associated lockdowns eased.

12.0 The invasion of Ukraine by Russia in February 2022, subsequent increases in energy costs and inflation, and the rises in interest rates post the Trust's financial year end, have served to raise both the risk of recession and the cost of debt. This in turn has led to a fall in commercial property values since March 2022, with commentators and analysts suggesting a peak to trough correction in capital values of 15-20% (or possibly more) by the middle of 2023. I would not expect the Trust's property portfolio to be immune to a pricing correction; although I would note that the Trust's borrowings are fixed (at ca 3%) for the long term, there is limited exposure to development and both the property and non-property investment portfolios are reasonably well diversified.

**Conclusions**

To the best of my knowledge I have been provided with all the information necessary to perform my role, and CRT have responded positively to my questions and feedback.

Based on my discussions with Officers of CRT and the evidence I have seen, I consider that CRT have managed the Investment Assets in accordance with the Group Investment Policy and that the GIP is in compliance with the statement of Agreed Purposes in the Grant Agreement.

Over the longer term the property portfolio has performed well and the non-property investments managed by Partners Capital have contributed positively to overall capital growth.

Having regard to this I have not detected actual Material Diminution to the Investment Assets or a Material Diversion of Protected Assets to purposes other than the Agreed Purposes as defined in the Agreement.

Yours sincerely,

Malcolm Naish

R M Naish
Protector

**PROTECTED ASSET FUND**

**CONSOLIDATED BALANCE SHEET**

AS AT 31 MARCH 2022

| | Note | **31 March 2022** | 31 March 2021 |
|---|---|---|---|
| | | **£m** | £m |
| **Fixed assets** | | | |
| Tangible assets | 2 | **21.3** | 21.2 |
| Investments: | | | |
| Property | 3 | **784.7** | 756.8 |
| Diversified funds | 4 | **289.9** | 223.4 |
| Subsidiaries | 5 | **-** | - |
| Joint Ventures: | | | |
| share of gross assets | 5 | **23.0** | 49.0 |
| share of gross liabilities | 5 | **(9.0)** | (24.0) |
| | | **1,109.9** | 1,026.4 |
| **Debtors:** Amounts falling due after one year | 6 | **11.6** | 12.3 |
| **Current assets** | | | |
| Stock | | **-** | - |
| Debtors | 6 | **(0.3)** | (1.9) |
| Investments | | **2.8** | 3.0 |
| Cash at bank and in hand | 7 | **24.3** | 21.9 |
| | | **38.5** | 35.3 |
| **Current liabilities** | | | |
| Creditors: amounts falling due within one year | 8 | **(10.5)** | (4.1) |
| **Net current assets** | | **28.0** | 31.2 |
| **Total assets less current liabilities** | | **1,137.9** | 1,057.6 |
| Creditors: amounts falling due after one year | 8 | **(150.0)** | (150.0) |
| Provisions for liabilities | 9 | **(0.2)** | (0.2) |
| **Net assets excluding pension fund liability** | | **987.7** | 907.4 |
| Pension fund asset/(liability) | 11 | **42.6** | (45.6) |
| **Net assets including pension fund liability** | | **1,030.3** | 861.8 |
| **Protected asset fund** | | | |
| Subsidiaries | | **56.3** | 31.0 |
| Other funds | | **974.0** | 830.8 |
| **Total fund** | 10 | **1,030.3** | 861.8 |