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

12th February 2022

Dear Secretary of State,

<u>CANAL & RIVER TRUST: REPORT OF THE PROTECTOR</u>

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 eighth formal report to Defra, covering CRT's Financial Year ended 31st March 2021.

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 financial year I have spoken with Officers of CRT on numerous occasions; by video conference and by telephone. In the capacity of observer, I have attended meetings (via video conferencing) of CRT's Investment Committee and have been provided with various Minutes, reports and other information, including the annual property valuation (as at 31st March 2021) 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 2020/21, and the Pro Forma Accounts for the Canal & River Trust Protected Asset Fund, for the year ended 31st March 2021.

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 the GIP was reviewed by CRT's Investment Committee and changes were subsequently recommended to, and approved by, the Trustees in November 2020. The amendments included, inter alia, a lower overall target return for the investment assets (reflecting the market outlook), variations in the sector allocations within the property holdings and a recognition that, over time, the Trust is committed to incorporating further environmental, social and governance (ESG) considerations into its' investment decision making. CRT shared these changes with me prior to presenting them to the Trustees and in my opinion they are reasonable and appropriate.

3.0 In the 12 months to end-March 2021 the total value of the Protected Endowment Net Assets (excluding the pension fund liability) rose from £871m to £907.4m; an increase of £36.4m (+4.2%). (See attachment: Protected Asset Fund Consolidated Balance Sheet.)

4.0 During the year, CRT sold 16 investment properties for a total consideration of £5.12m. In aggregate these properties achieved a price some 44.1% above their combined value at the start of the period (equivalent to +23.2% after costs). The Trust also sold an interest in a joint venture with receipt of the consideration (ca.£9.5m) deferred until a later date.

5.0 As at March 2021 the Investment Assets included 268 properties (excluding boating properties), of which the top 100 accounted for about 96% 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 8%.

7.0 Those property investment assets that are measured by MSCI produced a total return (income plus capital appreciation) of 3.2%. This figure reflected an income yield of 4.9% and capital appreciation of (minus) -1.6%. The market return, as represented by the MSCI UK Quarterly Property Index, was 1.2% for the 12 months to end-March 2021. According to MSCI, the Trust's property portfolio ranked in the upper quartile of portfolios within the benchmark, and over five and ten years remains one of the top performing portfolios in the Index. Inflation, as measured by the Retail Prices Index (RPI), during the same period stood at 0.6% (inflation as measured by CPI was 1% over the 12 months to March 2021).

8.0 The Trust's property investments therefore delivered a positive total return, again beating the MSCI benchmark. This good showing continued a run now extending to nine years in which the CRT property portfolio has outperformed the benchmark. Attribution analysis confirms that the Trust continued to benefit from an underweight holding of standard retail property and zero exposure to shopping centres. The retail sector remained vulnerable to weak tenant and investor demand, a trend which has been amplified by the accelerated shift to on-line shopping in the wake of the Covid-19 pandemic. Conversely, the Trust's holdings of industrial and warehouse property continued to perform well, in part driven by the increased activity of distributors servicing the needs of the online marketplace. The Trust's ownership of ground rents (ca 35% of the property portfolio by value) continued to offer a reliable source of income, coupled with lower downside capital risk.

9.0 I note that the property valuation as at 31st March 2021 prepared by Avison Young was not subject to a 'Material Valuation Uncertainty' clause, reflecting a return to more orderly market conditions.

10.0 During the Financial Year the non-property investment assets managed by Partners Capital produced a return of ca. 21% (in GBP and net of fees) and the value of the fund stood at £226.6m. This lagged the SAA Composite Benchmark (28% excluding FX adjustments), but since inception the total return from the non-property investments remains slightly ahead of this benchmark.

11.0 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.

12.0 During the year ended 31st March 2021 the news headlines were dominated by the Covid-19 pandemic. For periods of time non-essential businesses were required to close and people were asked to stay at home, subject to certain exemptions. This particularly impacted the retail sector, leading to the permanent loss of some stores and downward pressure on rental values more generally. Many retail tenants were granted financial concessions by their landlords (eg, deferred rental payments) and these measures, together with government support schemes (including furlough and the suspension of business rates), helped many businesses to weather the storm. Offices fared slightly better, with employers and employees adapting to either a full work from home regime, or a hybrid model where employees typically attend their offices for 2/3 days per week and working from home at other times. In contrast, the industrial sector, especially distribution warehouses, witnessed strong tenant demand, resulting in rental growth and a level of investor interest that drove up capital values. The MSCI Index illustrates this starkly: during the year shopping centres posted an average negative total return of -23.6%, whereas South East industrials delivered average positive total returns of +15%.

13.0 The roll out of the vaccination programme gives hope that something approaching normal life can be re-established in the near term. With that hope comes an expectation that economic growth will resume and investment markets will stabilise. It is against this background that the performance of the non-property investments managed by Partners Capital bounced backed following a poor showing in the prior yield.

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.

In relative terms the property portfolio continues to perform well and the non-property investments managed by Partners Capital 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 2021

	Note	**31 March 2021**	31 March 2020
		£m	£m
Fixed assets			
Tangible assets	2	**21.2**	25.2
Investments:			
Property	3	**756.8**	774.2
Diversified funds	4	**223.4**	183.2
Subsidiaries	5	**-**	-
Joint Ventures:			
share of gross assets	5	**49.0**	39.7
share of gross liabilities	5	**(24.0)**	(13.3)
		1,026.4	1,009.0
Debtors: Amounts falling due after one year	6	**12.3**	2.9
Current assets			
Stock		**-**	-
Debtors	6	**(1.9)**	(0.6)
Investments		**3.0**	3.0
Cash at bank and in hand	7	**21.9**	13.6
		35.3	18.9
Current liabilities			
Creditors: amounts falling due within one year	8	**(4.1)**	(6.2)
Net current assets		**31.2**	12.7
Total assets less current liabilities		**1,057.6**	1,021.7
Creditors:amounts falling due after one year	8	**(150.0)**	(150.1)
Provisions for liabilities	9	**(0.2)**	(0.6)
Net assets excluding pension fund liability		**907.4**	871.0
Pension fund liability	11	**(45.6)**	(22.3)
Net assets including pension fund liability		**861.8**	848.7
Protected asset fund			
Subsidiaries		**69.4**	63.4
Other funds		**792.4**	785.3
Total fund	10	**861.8**	848.7