Public Agenda

To:
All members of the Council

Please reply to:
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Date: 13 July 2016

Supplementary Agenda

Council - Thursday, 21 July 2016

Dear Councillor

I enclose the following items which were marked 'to follow' on the agenda for the Council meeting to be held on Thursday, 21 July 2016:

21. Exempt report - To request authority to increase the Council's prudential borrowing limit and request a supplementary Capital Estimate - Key Decision **3 - 22**

To consider a request for authority to increase the Council's prudential borrowing limit and request a supplementary Capital Estimate in order to acquire a site in the Borough.

Reason for exemption
This report contains exempt information within the meaning of Part 1 of Schedule 12A to the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985 and by the Local Government (Access to information) (Variation) Order 2006 Paragraph 3 – Information relating to the financial or business affairs of any particular person (including the authority holding that information) and in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information because the bidding process is confidential and disclosure of the Council's interest, or the sums it is likely to bid, would distort fair competition for the site and prejudice the Council's ability to acquire the site in the public interest.

Yours sincerely

Greg Halliwell
Corporate Governance

To the members of the Council

Councillors:

M.M. Attewell
C.B. Barnard
R.O. Barratt
I.J. Beardsmore
J.R. Boughtflower
S.J. Burkmar
S. Capes
R. Chandler
C.A. Davis
S.M. Doran
S.A. Dunn
Q.R. Edgington
T.J.M. Evans
K. Flurry
P.C. Forbes-Forsyth
M.P.C. Francis
C.M. Frazer
A.E. Friday (Mayor)
N.J. Gething
A.L. Griffiths
A.C. Harman
I.T.E. Harvey
N. Islam
A.T. Jones
J.G. Kavanagh
V.J. Leighton
M.J. Madams
A.J. Mitchell
S.C. Mooney
D. Patel
J.M. Pinkerton OBE
O. Rybinski
D. Saliagopoulos
J.R. Sexton
R.W. Sider BEM
R.A. Smith-Ainsley
B.B. Spoor
H.A. Thomson
H.R.D. Williams

COUNCIL

21 July 2016

Title	Investment acquisitions in the Borough		
Purpose of the report	To make a decision		
Report Author	Terry Collier, Chief Finance Officer Heather Morgan, Group Head Regeneration and Growth		
Cabinet Member	Councillor Ian Harvey	**Confidential**	Report No Appendices Yes
Corporate Priority	Value for money Council		
Cabinet Values	Community and Self-Reliance		
Recommendations	**Council is asked:** **To approve an additional supplementary capital estimate for property acquisitions within the Borough of £400m for 2016/17 to support the economic development and well-being of the borough and investment purposes** **To agree the revised set of prudential indicators which include increasing the operational boundary and authorised limit for external debt (Appendix 3)** **To confirm the Council's Minimum Revenue Provision policy to ensure prudent provision is made to cover repayment of loans (Appendix 3)**		

1. Key issues

Background

1.1 The Council is part way through implementing a wide reaching transformation programme - known as 'Towards a Sustainable Future' (TaSF). There are three strands: (1) use of assets and income generation (2) Knowle Green programme and new ways of working (3) structural review. This report links to assets and income generation.

1.2 The TaSF programme has been developed to ensure Spelthorne Borough Council is in a strong position to withstand the coming financial challenges. Since 2013/14 the Councils Revenue Support Grant (RSG) has fallen from £2.5m and stands at £580,000 for 2016/17. This financial year is the last year that the Council will receive RSG. Beyond this, the Council may well be responsible for paying back up to an estimated £750,000 each year to central government.

1.3 As part of its TaSF strategy, the Council has said that it effectively needs to be fully self-financing by 2020 in order to continue to deliver the services that it currently provides.

1.4 The reductions in RSG have been on-going for a number of years, and this, combined with the need to ‘stand on our own two feet’ financially, means it is imperative that the Council focuses on the most effective ways of increasing on-going income streams. One of the identified ways of doing this is through property investment and the Council previously allowed the Cabinet a fund of £6m to advance this policy.

1.5 A number of significant opportunities have arisen around the borough which will (if acquired) (i) allow the Council to secure the economic well-being of the borough and also (ii) bring in a substantial on-going income stream from investment assets. In order to be able to bid for these opportunities, Council need to:

(a) Agree a substantial supplementary capital estimate to enable the Council to grasp a number of opportunities within the Borough, and future opportunities

(b) Agree a revised set of prudential indicators which include increasing the operational boundary and authorised limit for external debt

(c) Confirm the Council’s Minimum Revenue Provision policy to ensure prudent provision is made to cover repayment of loans

Current budget position on acquisitions

1.6 In April 2016, the Council approved a revised Capital Programme for asset acquisitions of £45.455m for 2016/17. This allows the Council to acquire assets to (1) assist in the economic and social regeneration of Staines upon Thames and our other town centres (2) to assist in service provision and/or (3) to generate an on-going income stream.

Asset opportunities

1.7 As a Council, we need to be able to respond promptly to opportunities that arise in the property market. We are competing alongside commercial developers who are building in the borough, as well as institutional investors who are looking to acquire and hold sites for the medium to long term (for pensions/annuities).

1.8 A number of significant opportunities have arisen around the borough which would (if acquired) secure assets capable of generating considerable levels of income, increase our asset base and enable the Council to support the on-going economic well-being of the borough.

1.9 Details of one particular investment opportunity are set out in **confidential Appendix 1**. Given the likely market interest in the opportunity it is necessary to restrict public access to the considerations of the expenditure which the Council is currently considering.

1.10 Collectively, these opportunities will enable the Council to effect ‘meaningful change’ in the borough, and increase income streams. However, the Council does not necessarily wish to limit itself to these alone, and is considering developing a broad portfolio to achieve the required income growth. Other schemes may still be required. The Council needs to be in a clear position to act on any opportunities presented by the market and make decisions promptly. Whilst it is not possible to say with any high degree of certainty where these new opportunities might arise in the borough and the likely costs involved, officers suggest an increased figure (set out below but more fully explained in **confidential Appendix 1**) is made available for this purpose. This will enable Cabinet to consider sites in the knowledge that the capital is available in principle (subject to normal council procedures on Key Decisions and Cabinet approval to spend being subject to the usual call-in provisions etc).

2. Options analysis and proposal

Option 1 - in order to acquire a number of significant opportunities which have arisen around the borough referred to in **confidential Appendix 1** a supplementary capital estimate is required. The remaining capital will be used for acquiring additional properties/sites to aid service provision (affordable housing), economic and/or social regeneration or facilitate other prudent purchases to bring in income streams. To agree to borrowing of up to £442m for the reasons set out above.

Furthermore, as a result of the capital financing requirement, Council needs to agree that the operational boundary for external debt is increased up to £500m. Finally, Council need to agree the Minimum Revenue Provision (MRP) policy that the Council will be applying.

Risks

Option 1

2.1 The main risk to the Council is in purchasing an opportunity which (i) fails to appreciate in value at a sufficient rate, or at all (ii) costs more to manage than it yields in income or (iii) proves unsuitable for the service it is designed to deliver. These risks will be covered by the Cabinet in deciding if and how to spend the capital. Cabinet will consider how to hold the properties, and the business cases for each individual project.

Proposal

2.2 ***It is recommended:***

(a) ***that a supplementary capital estimate of £400m for 2016/17 is agreed.***

(b) ***that revised set of prudential indicators which include increasing the operational boundary and authorised limit for external debt are agreed***

(c) ***that the Council's Minimum Revenue Provision policy to ensure prudent provision is made to cover repayment of loans is confirmed***

3. Financial implications

3.1 Councils are in a strong financial position to acquire property due to their ability to access capital, coupled with the low cost of borrowing (for example Spelthorne can borrow at 2.25 to 2.75% long term at fixed rates from the

Public Works Loans Board (effectively the Bank of England) depending on the amount and length of a loan, whereas a developer would be likely to pay 5 - 6%). The Council is also able to borrow at cheaper rates from other councils.

3.2 It makes financial sense to borrow money at these rates rather than using the Council's own capital, which in the most recent financial year achieved an average of more than 5% return when re-invested in property funds. Whilst there may be some short term fluctuations associated with the UK Brexit decision, properties acquired are likely to appreciate in capital value over the longer term. Depending on the acquisition, there will be scope to achieve an on-going rental income stream. Detailed financial information is provided in **confidential Appendix 1**.

3.3 Historically this Council has been debt free, as have many others. However, in the current fiscal climate, councils are increasingly looking to borrow in order to enlarge their property portfolios, whether for income, service provision or regeneration purposes. Over the next two years the collective cumulative borrowing levels of all the Surrey districts and boroughs will reach nearly £2 billion.

3.4 Councils are able to set whatever borrowing limit they judge to be appropriate. However it clearly needs to be prudent and affordable. Importantly, we need to consider carefully the impact of increasing levels of debt, our ability to repay and the risk of increasing interest rates for those repayments.

3.5 Officers have sought advice from our Treasury Management advisors Arlingclose on a range of issues. They have confirmed they are comfortable with the level of borrowing required to sustain a supplementary capital estimate of £400m to acquire income generating assets (**Appendix 2**). It has also been recommended that the funds are not borrowed until any acquisitions are completed and the cash is physically needed.

3.6 As part of the annual budget setting process, officers are required to produce a set of prudential indictors which include the operational boundary and authorised limit for external debt. These therefore need to be revised, and an updated set are included as **Appendix 3** for approval.

3.7 If the additional estimate is agreed, the capital programme will increase in 2016/17 from £45.455m to £445.455m. As a result, the capital financing requirement and operational boundary for external debt has increased to £500m. In order to cover unexpected eventualities outside the remit of this specific report and 'just in case' scenarios on cash flow, it is deemed prudent to increase the authorised limit for external debt to £550m.

3.8 The Council will make appropriate Minimum Revenue Provision (MRP) deductions from the Revenue Budget on an annual basis to ensure sufficient sums are set aside to enable the Council to repay loans incurred on their maturity. The Council's Treasury Management advisers Arlingclose have provided advice on the most effective way to structure these MRP deductions. **Appendix 3** sets out the MRP policy the Council will be applying.

4. Other considerations

4.1 Council should note that should the additional capital estimate be agreed, Cabinet will need to consider the proposal to acquire the investment opportunity referred to above, and decide whether to agree to the actual expenditure.

5. Timetable for implementation

5.1 If the additional capital is agreed by Council, then Cabinet will meet immediately after to consider whether to acquire one specific investment opportunity which requires an urgent decision. This Cabinet report will include a thorough assessment of the opportunities (along with advice from our professional advisors). Only if Cabinet agree to proceed with this or any other acquisitions will any of the additional capital need to be spent.

5.2 The Cabinet report will set out timescales for this acquisition (should it agree to proceed).

Background papers: None

Appendices:

Appendix 1 contains exempt information within the meaning of Part 1 of Schedule 12A to the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985 and by the Local Government (Access to information) (Variation) Order 2006 Paragraph 3 – Information relating to the financial or business affairs of any particular person (including the authority holding that information) and in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information because, disclosure to the public would prejudice the financial position of the authority in the bidding process for the site by allowing other bidders to know the position of the Council. This in turn prejudices the community by (i) distorting the bids process and (ii) prejudicing the opportunity for the community to acquire a site through the Council for the social, environmental and economic benefit of the borough.

Appendix 1 - Financial information on the opportunity under consideration
Appendix 2 – Correspondence from Councils Treasury Management Advisors
Appendix 3 - Prudential Indicators Statement 2016/17

By virtue of paragraph(s) 1 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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Ryan Maslen
Spelthorne Borough Council
by e-mail

15th July 2016

Dear Ryan,

Spelthorne Borough Council Borrowing Strategy

As you are aware, we are Spelthorne Borough Council's Treasury Advisors, and have been asked to comment on the legitimacy of Spelthorne's plans to borrow in order to invest in a significant fixed asset.

The Council definitely has the legal power to do so. The Local Government Act 2003 gives the council the power to borrow for *"purpose relevant to its functions*" and *"for the purposes of the prudent management of its financial affairs"* (Section 1.1).

However, the Local Authority Capital Financing and Accounting Statutory Instrument 2003 also states that the council must follow the Prudential Code for Capital Finance in Local Authorities. This code, published by the Chartered Institute of Public Finance and Accountancy (CIPFA), states that any capital investment plans are *prudent, affordable* and *sustainable*.

With this in mind, the council must ensure that it takes care that the investment is suitable and in keeping with its long term revenue and capital spending plans. It should also be sure that the borrowing costs and all long term costs of the asset ownership are identified and are affordable in the long term, without adversely affecting the council's finances.

Therefore, as your treasury advisors, we are comfortable with you borrowing in order to make this purchase provided:

- Sufficient due diligence is taken on the purchase, including the council's ability to manage the asset, the quality of the asset and its current state
- Sufficient advice is sought, and acted upon, with regard to an appropriate purchase price
- The full costs and the expected return from the asset is sufficient to cover both budgeted debt interest and Minimum Revenue Provision payments
- That all financial analysis undertaken includes sufficient contingency in the case of unexpected costs or lower than projected income.

Please do not hesitate to contact us on 08448 808 200 should you wish to discuss any aspect of this letter further.

Arlingclose Ltd

60 Moorgate
London EC2R 6EL

Tel: 0844 8808 200
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Yours sincerely,

Mark Swallow, FCPFA
Technical Client Director
Arlingclose Ltd

Appendix 3

Prudential Indicators Statement 2016/17

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Council's planned capital expenditure may be summarised as follows.

Capital Expenditure and Financing	2015/16 Revised £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's
Gross Expenditure	1,995	445,455	406	406

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.16 Revised £000's	31.03.17 Estimate £000's	31.03.18 Estimate £000's	31.03.19 Estimate £000's
Total CFR	0	442,000	442,000	442,000

The CFR is forecast to increase during 2016/17 as any significant capital expenditure on replacement Council accommodation and other asset acquisitions will be financed by debt.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.16 Revised £000's	31.03.17 Estimate £000's	31.03.18 Estimate £000's	31.03.19 Estimate £000's
Total Debt	0	442,000	442,000	442,000

Total debt is expected to increase in line with the CFR requirement in 2016/17 and maintain at that level in future years.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	**2015/16 Revised £000's**	**2016/17 Estimate £000's**	**2017/18 Estimate £000's**	**2018/19 Estimate £000's**
Total Debt	4,000	500,000	442,000	442,000

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	**2015/16 Revised £000's**	**2016/17 Estimate £000's**	**2017/18 Estimate £000's**	**2018/19 Estimate £000's**
Total Debt	12,000	550,000	500,000	500,000

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2015/16 Revised %**	**2016/17 Estimate %**	**2017/18 Estimate %**	**2018/19 Estimate %**
General Fund	(4.64)	(8.43)	(11.04)	(10.77)

The ratios for Spelthorne are currently negative because the Council's investment income exceeds the cost of borrowing. This position is expected to improve further in the Council's favour in future years, due to interest rates for borrowing being at historically low levels and the significant levels of capital receipts the Council is expecting in 2016/17. These will be re-invested and are expected to provide an annual return of around 4%.

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact looks at the loss of interest which could be generated on the funds being used to finance the proposed capital programme.

Incremental Impact of Capital Investment Decisions	**2016/17 Estimate £**	**2017/18 Estimate £**	**2018/19 Estimate £**
Proposed Capital Programme	445,455,000	406,200	406,200
Estimated Interest earned on short term investments	0.50%	0.50%	0.50%
Estimated Tax Base	38,308	38,691	39,078
Incremental Impact on Band D Council Tax	58.14	0.05	0.05

Adoption of the CIPFA Treasury Management Code: The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition at its meeting on 24th January 2012.

Annual Minimum Revenue Provision Statement 2015/16

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance.

The Council expects that its Capital Financing Requirement will be nil on 31st March 2016 and in line with the CLG Guidance it will therefore charge no MRP in 2016/17.

Capital expenditure incurred during 2016/17 will not be subject to a MRP charge until 2017/18. It is proposed that the annuity method – one of the ready-made options in the guidance – is the most prudent and appropriate approach to be taken.

The annuity method makes provision for an annual charge to the General Fund which takes account of the time value of money (whereby paying £100 in 10 years' time is less of a burden than paying £100 now). The schedule of charges produced by the annuity method thus results in a consistent charge over an asset's life, taking into account the real value of the annual charges when they fall due.

The annuity method also matches the repayment profile to how the benefits of the asset financed by borrowing are consumed over its useful life (i.e. the method reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years). This re-profiling of MRP therefore conforms to the DCLG "Meaning of Prudent Provision" which provide that "debt [should be] repaid over a period that is reasonably commensurate with that which the capital expenditure provides benefits".