The Capital Strategy of Spelthorne Borough Council

Contents

1. Introduction

This document sets out Spelthorne Council's Capital Strategy. It gives residents and other stakeholders an overview of why, where and how we intend to spend capital to provide services and meet some of the Council's wider strategic aims. Supported by other documents including Asset Management plans and Treasury Management strategies, it spells out our priorities in the short-, medium- and long-term.

In particular, this document demonstrates how our Capital Strategy will help to deliver against two key goals contained in our Corporate Plan:

- **To deliver much-needed housing** in order to help reduce homelessness locally, increase affordable provision and help meet the overall need for additional homes.
- **To regenerate our town centres** so that we can contribute to the economic development of the Borough.

How capital expenditure is defined

Capital expenditure is money used by the Council to acquire, upgrade, and maintain physical assets such as property, operational buildings and equipment. Capital expenditure can include everything from repairing a roof or purchasing a piece of equipment to constructing a brand new building. Capital expenditure is different to revenue expenditure, which is the money used by the Council for the day-to-day delivery of services, staffing and supplies.

2. What is our Capital Strategy?

2.1 Put very simply, our Capital Strategy is to **Invest, Create, Deliver**.

- We have **invested** in commercial property which will deliver an ongoing sustainable income stream to support development activity
- We are **creating** new housing for residents and the regeneration of our town centres
- We are **delivering** the affordable homes which the market fails to provide and we are prioritising people who are on our Housing Register

2.2 Beyond housing, our Capital Strategy will also help us meet our need to upgrade and maintain:

- Operational buildings
- Infrastructure in the Borough
- Our vehicle fleet
- Our ICT infrastructure

2.3 **Our duty to look after public money**

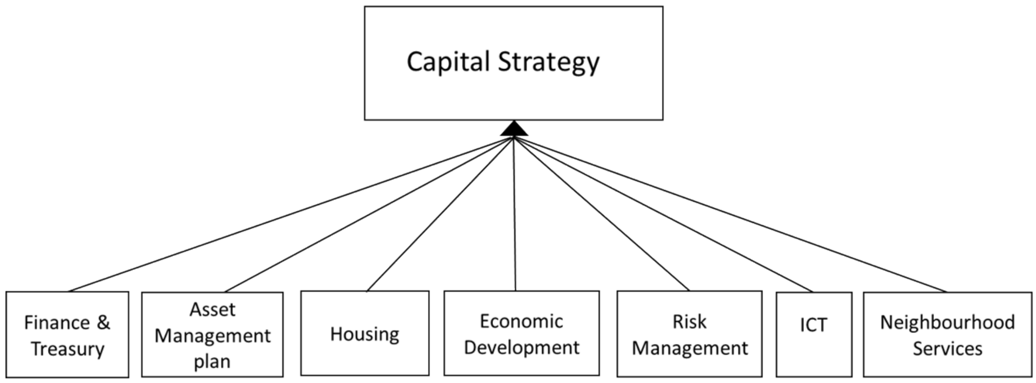
As a Council, we also have a duty to look after the public purse, and residents and businesses expect us to do so in a sensible and rational way. This Capital Strategy will demonstrate how we:

- **Finance our spending** through prudent borrowing and other sources of funding including use of reserves (called capital financing) within the upper level of our borrowing (called the external debt boundary)

- **Spend wisely and safely**, especially in relation to the investment portfolio that we hold (called commercial activity)
- **Manage risk and make decisions**, ensuring we have the appropriate skills and expertise, and taking a measured approach to investment
- **Ensure we have enough money** immediately to hand to keep services running on a day-to-day basis
- **Maximise our returns** on monetary investments (called treasury management)

2.4 Underpinning the whole Capital Strategy is the need to ensure that the Council achieves financial sustainability in the future (this is another Corporate Plan priority), something that is especially challenging in the current financial landscape.

3 How do existing strategies feed into the Capital Strategy?



3.1 The Council already has a number of strategies in place which cover various aspects of spending. We appreciate that it can be difficult to understand how all of these elements mesh together to form a 'whole', which is where the Capital Strategy comes in. By bringing everything together in one document, we can show how the need to invest in assets – such as the building of a new waste depot, for example – has a range of implications.

3.2 **An overview of our individual strategies**

The various strategies that we currently have in place are set out below, although some are being updated to reflect the intentions set out in this document. Please follow the links if you would like to read them in full.

3.3 **Medium Term Financial Strategy** *link* (also known as the Council's Outline Budget) – how the Council sees our need for revenue funding in the next five years

3.4 **Treasury Management Strategy** *link* – how the Council properly manages the money we have at hand (cash flow) to make sure money is always available to run the Council and deliver services

3.5 **Asset Management Plan** *link* – how the Council's assets support our corporate objectives and the services we provide. It sets out principles, priorities and action to ensure our assets are used and managed as efficiently and effectively as possible

3.6 **Housing and Homelessness Strategy** *link* – detailing the Council's strategic approach to ensure that there is a choice of housing options available to people living in Spelthorne, including supporting those who are homeless or at risk of homelessness, and preventing people from becoming homeless.

4 Where does the Council get its money from and what does it spend it on?

4.1 Our sources of income

The Council gets its money from a variety of sources – for 2018/19, our revenue funding is coming from:

	£	%
Interest Earned	900,000	4
General Grants from government	956,900	4
Our share of Council Tax	7,803,500	36
Our share of Business rates	4,300,000	20
Income from our investments	7,865,500	36
TOTAL	**21,825,900**	100

Table 1: Sources of income

4.2 What we fund

Our income is used to fund the range of services we provide – for 2018/19, this covers:

	Net cost after charges grants etc £		%
Electoral Registration & Elections	247,900		1
Democratic & Corporate Services	3,222,900		15
Grants to Community Organisations	209,600		1
Housing Benefits	323,200		2
Housing & Homelessness	1,780,700		8
Planned Maintenance	1,479,900		7
Planning & Economic Development	1,979,300		9
Asset Management	974,900		4
Environmental Services & Compliance	1,701,200		8
Refuse Collection	1,497,900		7
Street Cleaning	898,500		4
Grounds Maintenance	1,593,600		7
Community Wellbeing	393,300		2
Support Services & Central Overheads	4,776,000		22
Revenue Contribution to Capital	747,000		3
TOTAL	21,825,900		100

Table 2: What we fund

4.3 **Our capital expenditure plans**

In 2019/20, the Council is planning capital expenditure of £78m as summarised below:

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
Other Services Programme	273	335	48.3	0.5	0.5
Housing Investment Programme	0	10	29	51	38.6
ICT	0.4	0.3	0.5	0.1	0.1
Waste, Parks and Parking	0.9	0.5	0.3	0.1	0.1
TOTAL	275.3	345.8	78.1	51.7	39.3

Table 3: Prudential indicator: estimates of capital expenditure in £ millions

4.4 Our capital projects include:

- Investment property acquisitions to generate revenue income streams
- Property development projects for operational purposes e.g. for supporting housing service needs (Expenditure: £10m 2018/19; £29m 2019/20; £51m 2020/21)
- Leisure centre refurbishment / development (Original budget estimate for initial fees: £2m. This is being reviewed, with costs dependant on new location and facilities)
- Various corporate projects including facilities improvements and IT (including document management system, Customer Relationship Management (CRM), hardware and software)
- Waste, parks and parking includes new waste vehicles, reducing carbon footprint, improving management of parks and open spaces and enhancing CCTV.

4.5 The Council also plans to incur £78m of capital expenditure on housing and regeneration within the Borough (as per the table above), which are detailed later in this report in paragraph 7.9. For full details of the Council's Capital Programme, including the project appraisals undertaken, see: [link to be provided]

4.6 All capital expenditure must be financed either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the above expenditure is as follows:

4.7 On our commercial asset acquisitions the overall initial net yield (before financing costs etc) is 4.89%. As there is upwards indexation of the rental every five years on most of the assets, the yield is likely to rise over time. After taking account of paying off loan instalments each year, interest, supervision costs and setting aside in the sinking funds to cover future potential costs such as refurbishments of assets on lease expiry and rent-free periods, the net surplus contribution to the Council's Revenue Budget in 2019/20 will be £10.1m per annum.

Where our borrowing comes from

	2018/19 as at end of Aug 18 £'000	**2018/19 remainder £'000**	**2018/19 full year forecast £'000**	**2019/20 budget £'000**	**2020/21 budget £'000**	**Total 2018/21 £'000**
PWLB	364,000	29,000	393,000	80,000	39,000	551,000
Of which to be used for refinancing existing debt	0	0	0	0	0	0
Other sources	16,000	6,000	22,000	0	0,000	6,000
Of which to be used for refinancing	0	0	0	0	0	0

existing debt						
Total PWLB and other sources	380,000	35,000	415,000	80000	39,000	557,000
Of which to be used for refinancing existing debt	0	0	0	0	0	0
Of which to be used funding new long term borrowing	**380,000**	**35,000**	**415,000**	**80,000**	**39,000**	**557,000**

Table 4. Source of borrowing

4.8 **Background**

Over the last five years, the Council has seen a year-on-year reduction in the funding we receive from central government.

Making up the shortfall

The Council had to take a view on how to offset the loss of general Revenue Support Grant, with these the only viable options:

(1) Grow income

(2) Reconfigure, reduce or deliver services in a different way

(3) A combination of both the above

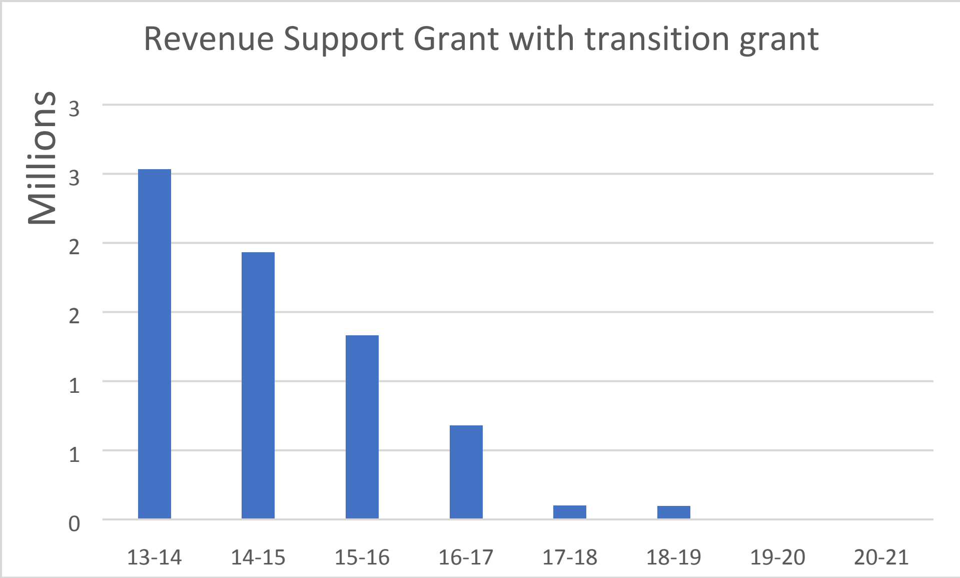


Illustration 1: Reduced Government funding

4.9 **Our investment so far**

Although this Capital Strategy looks forward, it is worth noting the significant level of investment activity that the Council has already undertaken. *Appendix 1* sets out the historical background to our acquisitions up to 2018, including our first major acquisition - the BP international campus in Sunbury. Information is included to explain why we set out on this journey, our previous 'Towards a Sustainable Future' programme, and our activity up to 2018.

4.10 Total commercial investments are currently valued at £933m, providing a gross average return of 4.89% and the Council has chosen, after taking account of interest and repayment of debt, to accept a net surplus contribution of 1% and to set aside a significant contribution into sinking funds to ensure we have funds available in future to cover voids and refurbishments. This is a comparable net return to that being achieved by pension funds on commercial assets.

Assets	Town	Sector	£m	Purchase Date
BP Campus, Sunbury Business Park	Sunbury	Office	385	Sept 2016
12 Hammersmith Grove	London	Office	170	Jan 2018
The Charter Building	Uxbridge	Office	119	Aug 2018
Thames Tower	Reading	Office	97	Aug 2018
The Porter Building	Slough	Office	66	Aug 2018
World Business Centre 4	Heathrow	Office	47	Aug 2018
3 Roundwood Avenue	Heathrow	Office	21	Sept 2017
Communications House	Staines	Office	11	July 2018
Elmsleigh Shopping Centre	Staines	Retail	10	Oct 2006
Elmbrook House	Sunbury	Office	7	Dec 2016
TOTAL			**933**	

Table 5: The Council's commercial assets portfolio

4.11 On our commercial asset acquisitions, the overall initial net yield is 4.89%. As there is upwards indexation of the rental every five years on most of the assets, over time the yield is likely to rise. After taking account of paying off loan instalments each year, interest, supervision costs and setting aside in the sinking funds to cover future potential costs such as refurbishments of assets on lease expiry and rent-free periods, the net surplus contribution to the Council's Revenue Budget in 2019/20 will be £9.8m per annum.

5 What if we had not invested?

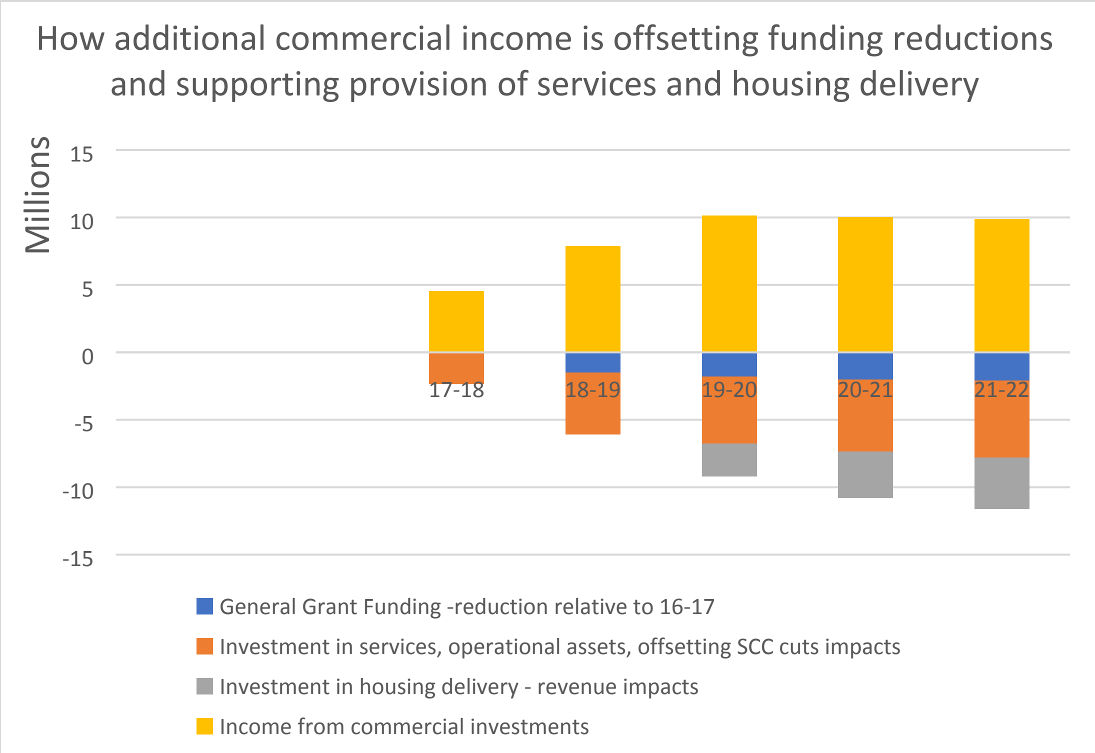


Illustration 2: The growing role of commercial income in the Council's funding of services

5.1 If the Council had not taken the decision to invest to deliver significant commercial income from 2016-2018, this would have led to major cuts in services, particularly the services we are not under a statutory duty to deliver such as:

- Day Centres (net cost of £384,000)
- Meals on Wheels (net cost of £48,900)
- Spelride Community Transport net cost (£186,600)
- Extension of the Greeno Centre to provide additional facilities for older people (additional £100k investment)
- New Meals on Wheels vans (£126,000) or Spelride vehicles (£250,000)

5.2 It would also have led to a reduction in the overall capacity of the Council to deliver for residents, leading to:

- Reduced maintenance of parks and open spaces
- Reduced waste collection frequency
- Increased budget for planned maintenance of frontline operational assets supporting service delivery (additional £750,000 per annum)

- Need for revenue contributions to capital expenditure to cover projects not financed by grant, receipts or generating revenue savings/income (£750,000 per annum)
- Increased fees and charges, such as significantly increasing car parking charges
- Inability to plug the considerable gaps which are emerging as a result of Surrey County Council cuts on social care services (estimated impact on Spelthorne budget to date is approximately £500,000)

Some of these cuts would have hit older and vulnerable residents the hardest.

The additional income the Council has generated has enabled us to put our Revenue budget on a more sustainable footing by ceasing to use reserves to support the Revenue Budget (in 2016/17 Budget - £786,000 use of reserves)

6 Our commercial investment activity

6.1 Since 2016, the Council has made a number of prime commercial investments, all of which are in the Heathrow economic area. The Council considers that defining an economic area restricted to Spelthorne only is to ignore the reality that Heathrow Airport is the real driver of the economy for West London, North Surrey and the Thames Valley. We are part of that economic zone and the airport plays an important role in our local economy. 7% of our resident's (6,700 in 2018) work at Heathrow, and this figure increases to 25% in our two northernmost wards. For every 10 direct jobs at Heathrow, there are 26 jobs created locally within the supply chain. The future expansion of the airport is something that the Borough has supported for a number of years, as long as the proposed scheme comprehensively and effectively mitigates the impacts on our communities, businesses, services and environment.

6.2 **An overview of our assets and approach**

The Council has chosen to invest in best-in-class assets which have a presence in the Heathrow economic area and are very well sited next to transport hubs.

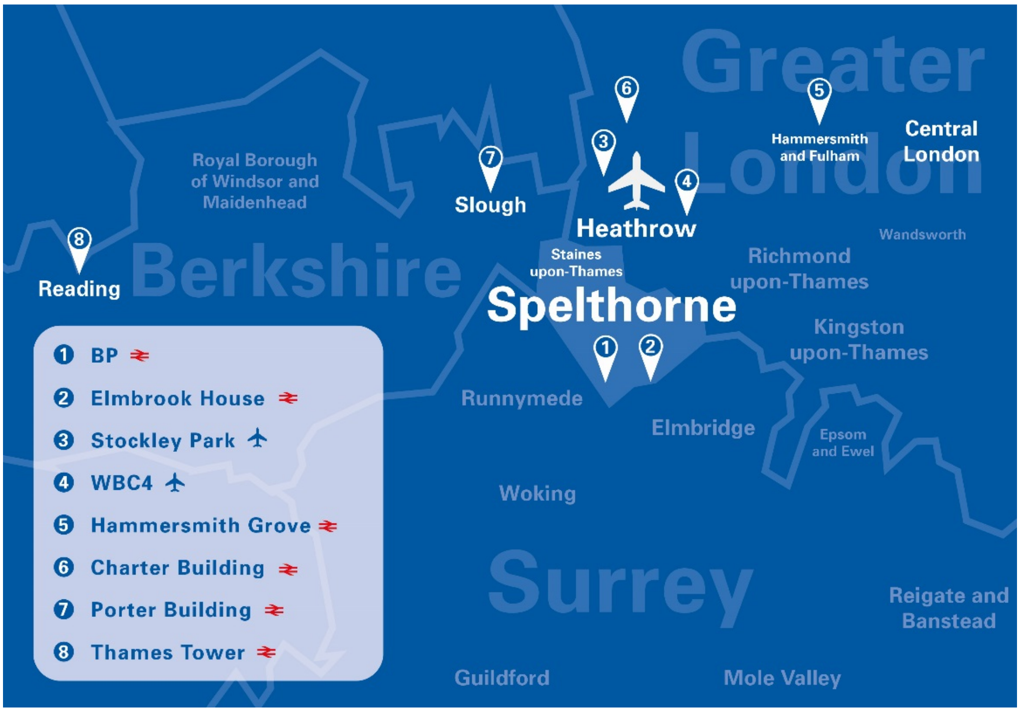


illustration 3: Location of our commercial assets

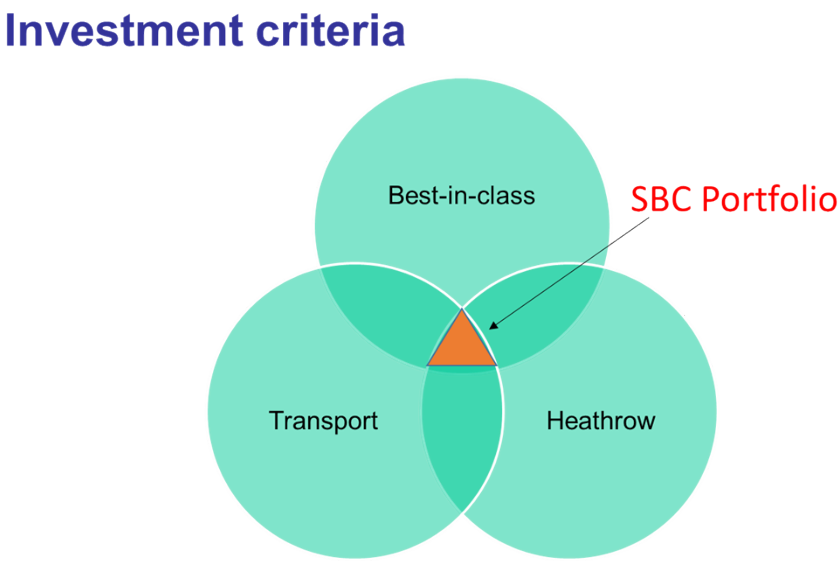


Illustration 4: Factors shaping our investment decisions

6.3 The Council has invested in properties that have attracted a strong and diverse tenant mix from different sectors of the economy. These are blue-chip tenants which provide good levels of security for the Council’s investment activities.

6.4 **Repayment allocation - as at August 2018**

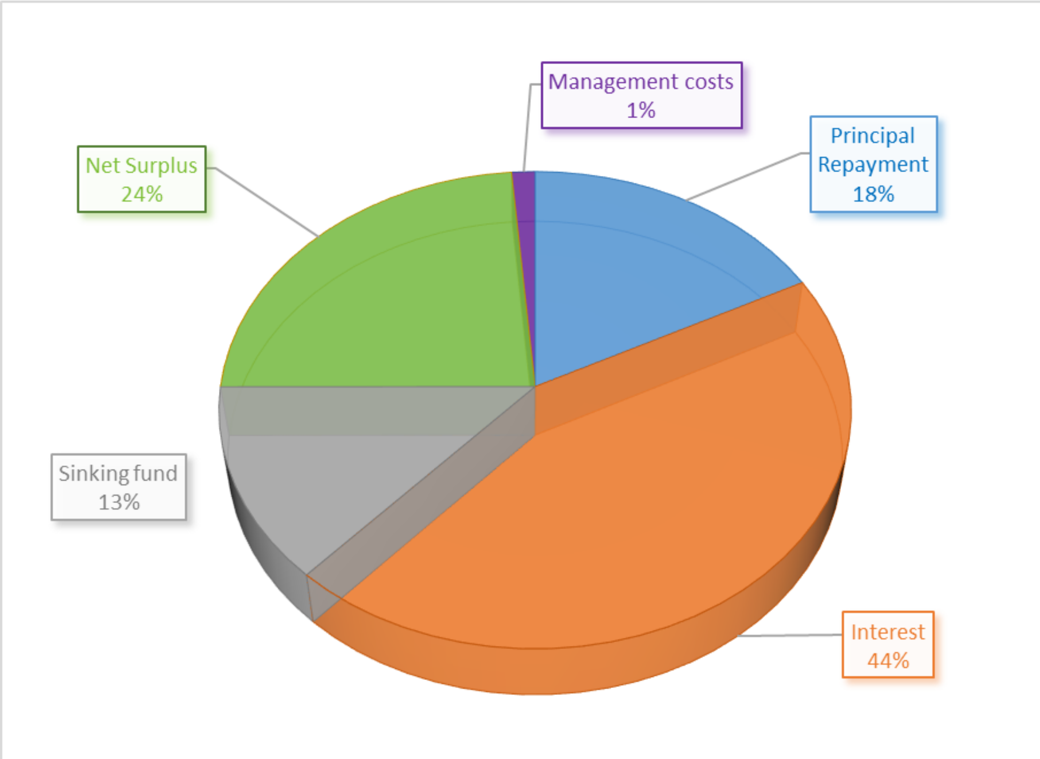


illustration 5: How loans are repaid and money allocated

The income from our investments (see Table 1, above) has made a substantial impact on the stability of the Council. In 2017/18 the net surplus (after making allowances for management costs, interest etc.) was around £7.5m.

6.5 **Our reasons for investing**

In order to fund our developments we have acquisition parameters – they are set out in full in *Appendix 2***,** but these are the primary reasons we have previously invested:

- to generate income to offset reducing Government funding and other pressures in order to support provision of services for residents
- for housing development
- for strategic purposes to allow for regeneration either now or in the future.

Having achieved our objective of significantly boosting our income to support provision of services, our focus is now on the second and third objectives set out above. It is also important to note that we maintain the assets which we purchased in 2016-2018 and which support the revenue budget. We regularly review and update our acquisition parameters.

7 The focus on housing and homelessness

7.1 The focus of the Council was previously to generate revenue in order to safeguard its basic services. The focus now is on providing affordable housing. Housing is one of the Council's four strategic priorities in the **Corporate Plan,** reflecting the significant pressures the Borough is facing, with relatively high numbers of families in temporary accommodation, insufficient affordable housing provided by Registered Providers of social housing and a severe shortage of affordable private rental housing supply.

7.2 **Local housing need**

Going back to the 1990s, the Council used to provide traditional council housing. In the 1990s, it was decided to transfer the council housing stock to what was then Spelthorne Housing Association and is now part of A2Dominion. The main reason for the transfer of properties at the time was the need to bring the properties up to an acceptable state of repair, which the Council could not afford at the time. Since then, the council has not had a direct role in the development of homes; this has been carried out by A2Dominion and other Registered Providers, as well as private developers. Fluctuation in the delivery of new housing has been dictated by the economy and the availability of grant funding to subsidise affordable housing.

7.3 The Council's Housing Strategy 2014-19 contains five strategic priorities which will contribute to achieving the overall vision of 'ensuring best quality homes in a thriving and sustainable community'. Additionally, the Council is required to have a Homelessness Strategy, which outlines the Council's approach to preventing homelessness.

7.4 In common with many other local authorities in the South East, Spelthorne has a growing demand for genuinely affordable housing and is facing a number of key challenges:

- **Increasing numbers on the Housing Register**: Over the past three years, the number of applicants on the Council's Housing Register has grown by 79%. See *Appendix 3* Table H1
- **Lack of availability of existing affordable housing**: In 2017/18 there were eleven applicants for every social housing vacancy. See *Appendix 3* Table H2

- **High rates of statutory homelessness**: There is an average of 116 Main Duty acceptances per year, with one in five approaches due to the termination of a private sector tenancy. See *Appendix 3* Table H3
- **High use of emergency and temporary housing for homeless households**: The average occupancy of temporary accommodation at the end of each quarter in the four years to 2017/18 was 111 households. See *Appendix* 3 Table H4. For example, the average cost to the Council to accommodate one homeless household in emergency housing is approximately £6,500 per annum
- **Increasing affordability issues**: ratio of the median house price to the median wage in the area evidences a year-on-year rise over the past four years, with Spelthorne outpacing the ratios for both the South East and England. See *Appendix 3* Table H5
- **Lack of new-build affordable housing**: The net increase of provision over the past four years has been just 152 units – an average of 38 per year. See *Appendix 3* Table H6

7.5 **The effect of our proximity to London**

As well as the evident demand for affordable housing from local residents, there is also considerable pressure from London. The cost of housing in London is even higher than in Spelthorne, and London boroughs are actively placing homeless households from their boroughs into Spelthorne, as well as 'block booking' emergency accommodation facilities within Spelthorne for their homeless people, placing further demand on the already strained private sector.

7.6 **The Heathrow expansion**

Another key issue that will have a significant impact on our community is the proposed third runway at Heathrow airport and the major expansion of works which are planned for Heathrow. Work on various parts of the airport and the surrounding infrastructure is likely to go on for around nine years. This will introduce further pressure as people working on the Heathrow expansion seek to be housed close to their workplace.

7.7 **Key worker accommodation**

Whilst housing affordability is a significant issue in general, it acutely affects key workers, who help to run the essential local services such as schools, hospitals, doctor surgeries and fire stations. According to Government statistics released in

2016, the latest records available, the mean income for employed households within Spelthorne is £33,500. However, the starting salaries for essential local workers is much less. Table H6 in **Appendix 3** shows the starting salaries for newly qualified professionals outside of London. We know anecdotally that key worker staff are moving further and further away from Spelthorne into Hampshire and Berkshire and commuting to work. This means that when they look for their next promotion they are more likely to look in those areas; this is another factor leading to loss of workforce. Whilst some key workers are being recruited from London, one of the main factors which will keep them in Spelthorne is availability of affordable housing. The Council is seeking to tackle this through our housing company Knowle Green Estates Ltd (paragraph 6.12).

7.8 **Strategic objectives**

In 2018 government and CIPFA guidance to local authorities changed with regards to borrowing to invest in commercial properties. The council has carefully considered this guidance and this Capital Strategy reflects both that guidance and our strategic objectives of borrowing in order to support housing investment.

As detailed above (see section 2), the Council's strategic objectives are to **invest, create, and deliver**.

7.9 **Subsidies are key**

As affordable housing is provided at up to 80% of the market rate, subsidies are essential to make it viable. A private developer who pays market rate for land, finance, supplies and labour has to sell their properties at market rate to make a profit. When Spelthorne Council is acting as the developer, even if we forgo the profit element, it is still difficult to deliver truly affordable housing.

7.10 Housing for rent can pay for itself over a period of time because of the rental income which it generates. However, the Council needs to be in a position to forward fund such developments and the cost of finance for the acquisition, development and construction stages is prohibitive for councils unless they receive government subsidy. This is similar to the way in which Housing Associations operate – having a market rate product to sell and rent, the surplus of which subsidises the affordable elements of their business.

7.11 The bottom line is that, even with the Government grant funding available through Homes England, affordable housing developments need significant capital investment and cash flow to deliver.

7.12 Spelthorne's Housing Development Programme

Spelthorne has a pipeline of properties for residential development:

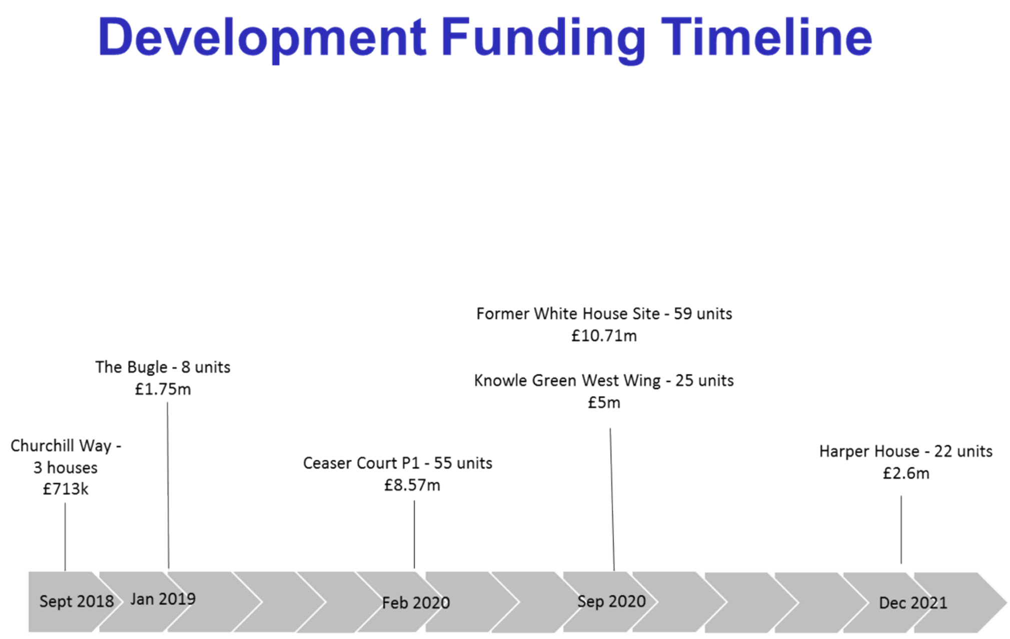


Illustration 6: Projected funding

7.12 Knowle Green Estates Ltd (KGE)

The Council formed its housing company in 2016 when we acquired Harper House in Ashford for emergency accommodation. Since then, the Council has made numerous improvements to make Harper House a safer and better managed solution for families who have been made homeless.

We also identified a need to promote our own affordable housing schemes, and KGE is the vehicle we use to deliver them to residents. We currently have a number of projects in the pipeline which will deliver 20% of the Borough's assessed 5-year land supply requirement in the Local Plan (628 units to be delivered by the Council out of a required 3,218).

KGE performs several functions on behalf of Spelthorne Borough Council, as outlined in the table below.

How we share housing functions with KGE

	Owned by	Developed by	Managed by
Investments	Council	n/a	KGE
Municipal	Council	Council / KGE	KGE
Residential	KGE	Council / KGE	KGE

Table 6: KGE and Spelthorne's roles in housing provision

7.13 **Development costs**

Developing homes results in upfront costs such as planning and construction which have to be financed before the housing units are let and start to generate income streams. This creates a short-term financial pressure on the Council's Revenue Budget and an immediate need to generate additional income from investment assets to offset these costs. The estimated revenue financing impacts of the current housing delivery programme is:

		19-20	20-21	21-22	22-23
		£	£	£	£
Total Development costs impact		2,441,400	3,420,800	3,785,800	271,500

8 The focus on economic development

8.1 Economic development is another one of the Council's four strategic priorities and reflects the importance that the Council places on stimulating more investment, jobs and visitors to Spelthorne in order to further the overall economic wellbeing and prosperity of the Borough and its residents. How we look to achieve this is set out in the Economic Strategy. Importantly, a vibrant economy also provides income through our share of business rates, helping the Council to be financially sustainable. Where and how we invest our capital plays a central role in terms of economic development.

8.2 **Significant progress**

It is true for all local authority areas that, if they do not pay close attention to the economic development and vitality of their area, they will move backwards as other areas around them move forwards. In previous years, the Council has made significant changes to Staines-upon-Thames which have revitalised the town centre. These include contributing to the development of the Two Rivers shopping centre, pedestrianisation of the High Street and the upgrading of the Riverside area around Memorial Gardens and Market Square.

8.3 The Council has significant landholdings in Staines-upon-Thames, and has made a number of recent acquisitions in line with our investment parameters to further cement our position. We bought back the long leaseholds of both Communications House and Thameside House so we now have control over a key portion of the town centre close to the River Thames. The Council also acquired Hanover House, which sits on the River adjacent to Bridge Street car park and represents a major redevelopment opportunity. We will continue to acquire properties where it makes strategic sense to do so for regeneration purposes.

8.4 Further work needs to be done in Staines-upon-Thames and that there is considerable scope for improvement around Sunbury Cross. So the aspirations of the Council should therefore be bold and ambitious.

8.5 **Planning to meet housing need**

There is a need as part of the current review of the Council's Local Plan to create around 590 housing units each year over the next 15 years. As part of its Issues and Options Consultation in summer 2018, the Council consulted on four main ways to meet this significant requirement for new housing:

- Brownfield development
- Green belt development
- Staines development
- Combination development

8.6 Following a Sustainability Appraisal, the professional opinion was that the fourth option (combination) should be taken forward, but with additional safeguards to take account of the public's views on loss of Green Belt. This has been agreed by Cabinet. Within this option, the focus will need to remain very much on realising the considerable latent potential of Staines-upon-Thames (but not to the absolute exclusion of housing development anywhere else in the borough).

The Strategic Housing Availability Assessment (SLAA) 2018 estimates that the 5-year housing land supply in the borough is 3,448 units on 64 sites. Over 1,420 of these units are expected to be delivered in Staines- upon-Thames, with around 420 to be delivered on Council-owned sites. In the medium term (6 to 10 years), Council-owned sites could deliver another 1000 units (with other sites not owned by Spelthorne bringing forward approximately 250).

8.7 The preferred approach of focusing on Staines-upon-Thames as the major residential opportunity area will be guided by Capacity Study. A Masterplan will then be developed as part of the new Local Plan which will focus in detail on where and how this new development can best be accommodated, in order to ensure we achieve a sustainable solution for the town.

8.8 The Council's landholdings within the town centre (including our recent strategic acquisitions) provide a clear opportunity to bring forward at least 1,420 units in the next 10 years. In the next five years, the level of investment that the Council aims to make is likely to be in the region of £300m. As the land owner, we are confident that we can deliver this level of residential development whilst retaining sufficient car parking to sustain the town centre (though some sites may well be reconfigured to make more efficient use of the land that we have).

8.9 The SLAA has identified that, within the town centre, the Council is able to develop the following housing units as a minimum (within the immediate confines of the town centre):

Thameside House	flatted	120 units	Years 1 - 5
Hanover House and Bridge Street car park	mixed use	300 units	Years 1 – 5
Riverside car park (subject to re-provision)	flatted	100 units	Years 6 – 10
Elmsleigh Centre and adjoining land	flatted	650 units	Years 6 - 10

8.10 The Council is currently part of a consortium promoting a light rail link to Heathrow from Staines-upon-Thames – the Southern Light Rail (SLR). A proposal has been made to the Department for Transport setting out the details of the scheme, and making clear that it will be entirely privately funded (this is known as a market-led proposal). There are a number of potential investors and it is not envisaged at this stage that the Council will be contributing to the capital cost of around £375m.

9 How we finance our capital spend

9.1 As referred to in Table 4,Section 3, above, we finance our capital expenditure from a range of sources. These include:

- **Revenue Contributions to Capital** – beginning in 2018-19, we are now funding £750,000 per annum of our capital programme from the Council's Revenue Budget contribution. This covers most of the capital items which are not funded by grant or will not generate revenue savings or revenue income streams. This puts these elements of the Capital Programme on a more sustainable basis
- **Grants** – principally Disabled Facilities Grant. The Council may seek grant assistance from sources such as Homes England for some of our housing delivery schemes such as the Homelessness Hostel
- **Community Infrastructure Levy (CIL)** - the Council will apply our share of CIL to support capital schemes which meet the CIL criteria
- **S106 funds (planning contributions from developers)** – we will use s106 funds to support affordable housing schemes
- **Capital receipts –** these are generated from either the Council's share of Right to Buy proceeds on housing stock, which used to belong to the Council before the transfer to Spelthorne Housing Association (now A2D) in the 1990s, or from sales of other assets
- **Borrowing** – mainly from the Public Works Loans Board at fixed rates. Some borrowing on a shorter term basis from other local authorities. In future, further borrowing will be focused on financing directly housing and regeneration within the Borough

10 How we manage risk and ensure sound decision-making

10.1 The Council needs to ensure that we have clear ways of mitigating the risks that are inherent in acquiring property and in bringing forward development. We must also show that we have the right decision-making processes in place with robust checks and balances (this is called governance). *Appendix 4* sets out our risk management approach in more detail.

10.2 **Risks**

From a risk management perspective, and in order to ensure the Council's investments are as safe as possible, we have employed a range of due diligence techniques, including:

- Evaluation of tenants by external global property advisers
- Using industry-standard information sources such as the credit rating agency Standard and Poor's
- Modelling the impact of tenant failure (and securing parent company guarantees where necessary) and setting aside money from investments to establish sinking funds to cover worst-case scenarios and possible future voids

10.3 We are also very clear on how we spread risk by diversifying the portfolio. In any commercial property portfolio, it is important to achieve a level of diversification in order to ensure that 'not all of our eggs are in one basket'. Portfolios can be diversified by property type (e.g. office, residential, industrial or retail), sector (e.g. pharmaceutical, media or fin-tech) and geography (e.g. local Borough or Heathrow). The Council's portfolio is heavily weighted towards the south-east office market, but the tenant mix is diversified. The Council will keep under continuous review the performance of our portfolio of commercial assets.

10.4 Under the Council's constitution, risk management is overseen by the Audit Committee, which reviews the Corporate Risk Register at each meeting. The Corporate Risk Register is also reviewed by Cabinet on a quarterly basis. Risk management is an integral aspect of the Council's project methodology, with projects required at initiation to identify risks and how they mitigate them, and to maintain a project risk register. The approach to risk management includes planning and identification, monitoring and review for all risks and projects throughout their lifecycle. The Corporate Risk Register includes details of commercial investments. A key focus of our approach to commercial assets is to ensure that we understand the full range of risks – including the financial robustness of tenants and guarantors, legal risks, and physical and locational risks – so that we put in place appropriate risk mitigation measures.

10.5 **Skills**

The changing nature of our portfolio has meant that we have enhanced our property team to ensure that we have with the right mix and level of skills and commercial experience. The Council also employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions (including treasury management). The cost of strengthening of our property team has been met through funding and management set-asides from investment income. There is now an 11-strong asset management team which includes a manager of the property unit formerly employed by BAA who brings considerable expertise in the commercial property market around Heathrow; a development manager with significant experience of building residential property in the private sector; and a property manager formerly at a commercial fund.

10.6 The Council will ensure that the assets team continues to grow in proportion to size of our investment and development activity. We have added further resources to our in-house finance team and legal team to support this acquisition and development activity. We also encourage our professional staff to complete ongoing continuous professional development, ensuring expertise levels are maintained.

10.7 Where we do not have necessary knowledge and skills within the Council team, we use external advisers and consultants that are specialists in their field. These include Clyde and Co (legal), Cushman and Wakefield (property and valuation), Arlingclose Limited (treasury management), Landid (asset management), Standard and Poor's (credit rating) and Deloitte (valuation and financial evaluation). This ensures that we have access to experts who can help us to operate in line with our risk appetite. We also seek to ensure that our councillors' knowledge on our approach to investments (both treasury management and commercial) is appropriately maintained.

10.8 **Governance**

The Council needs to ensure that we consider all opportunities in a managed way, and that we do so as transparently as we can (bearing in mind we are making commercially sensitive decisions). All property acquisitions are overseen by a small group of senior councillors and officers including the Leader of the Council, who has a background in property investment and the Finance Portfolio Holder, whose background is in corporate finance. Councillors are involved at key stages of the process (which is set out at the end of *Appendix 4*).

10.9 The Council is committed to following local government guidelines and we take appropriate legal and technical advice to ensure we are always doing so.

11 How we ensure we have enough money day-to-day and maximise return on investment

11.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, whilst managing the risks involved. Surplus cash is invested until required, and a shortage of cash is met by borrowing – this avoids excessive credit balances or overdrafts in the bank current account. The Council is typically cash-rich in the short-term as revenue income is received before it is spent, but cash-poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

11.2 **Current borrowings**

Based on acquisitions and investment decisions up to 31 December 2018, the Council currently has £1,031m borrowing at an average interest rate of 1.85%, and £19.5m pooled and medium term treasury investments at an average rate of 4.37% (based on the position as at end December 2018). *Appendix 5* sets out in detail how this is achieved with the headline information set out below.

11.3 **Factors shaping our borrowing decisions**

From a borrowing point of view, the Council needs to achieve a low but certain cost of finance whilst retaining flexibility should plans change in future. This requires striking a balance between cheap short-term loans and long-term fixed rate loans where the future cost is known, but higher. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. This is the approach that the Council takes.

11.4 In addition to the above, the Council is legally obliged to set an affordable borrowing limit (also termed the 'authorised limit for external debt') each year and to keep it under review. In line with statutory guidance, a lower 'operational boundary' is also set as a warning level should debt approach the limit. *Appendix 5* provides more detail on the boundary and the limit.

11.5 The Council's policy on treasury investments is to prioritise security and liquidity over yield – in other words, we focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in ‘pooled funds’, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice. The breakdown of near-term and longer-term investments is set out in *Appendix 5.*

11.6 In addition to debt of £1,033m detailed above, the Council is committed to making future payments to cover the pension fund deficit (valued at £44.86m). We have also set aside £2.23m to cover risks of business rates appeals, and £6m per annum into sinking funds to cover future liabilities on our investment properties.

11.7 Sound treasury management also has to consider the impact on the Revenue budget. Although capital expenditure is not charged directly to the Revenue Budget, interest payable on loans and Minimum Revenue Provision (i.e. repayment of loans provision) / loans fund repayments *are* charged to Revenue, and this is offset by any investment income (details of revenue implications of capital expenditure will be found in the 2019/20 revenue budget). *link*.

11.8 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Chief Finance Officer is satisfied that the proposed Capital Programme and recent capital expenditure decisions are prudent, affordable and sustainable. 50-year forecasting is undertaken on a base and worst case basis for commercial assets to estimate future liabilities – this ensures sufficient funds are set aside in sinking funds to meet those liabilities.

11.9 The Council has put the maintenance of our operational assets on a more sustainable basis by increasing the planned maintenance budget by £750,000 per annum over last two financial years and addressing a number of backlog maintenance issues at the Council Offices as part of a refurbishment project. The Council has also put the funding of our Capital Programme on a more sustainable basis by making annual revenue contributions to capital.

APPENDICES –

Historic background - included

Investment parameters - included

Housing information - included

Risks and decision making - included

Treasury Management - included