

REPORT TO STRATEGY & RESOURCES COMMITTEE – 14TH JUNE 2018 - AGENDA ITEM 8	
INVESTMENT AND DEVELOPMENT FUND	
Report of:	Kathy O'Leary, Strategic Director of Resources - 01883 732717 <a href="mailto:koleary@tanridge.gov.uk">koleary@tanridge.gov.uk</a>
Purpose of Report :	To seek agreement to combine the Property Investment Fund and Development Fund for the purchase of land and buildings and delivery of corporate projects, to increase the size of the fund, to amend prudential indicators and to also amend Financial Regulation 17 to extend delegated authority to the Chief Executive in consultation with the Leader of the Council and the Chair of the Housing Committee to acquire property in the Housing Revenue Account (HRA) for the Council's House Building Programme.
Publication status:	Unrestricted
Recommendations:	<p>That the Committee recommends to Council that:</p> <p>A. the £50 million Property Investment Fund and the £20 million Development Fund be combined to form a single Investment &amp; Development Fund and for this fund to be increased to £200 million, with consequent amendments to Financial Regulation 17;</p> <p>B. delegated authority be extended to include the ability of the Chief Executive, in consultation with the Leader of the Council and the Chair of the Housing Committee, to acquire land and buildings in the Housing Revenue Account (HRA) for the Council House Building Programme, subject to the criteria set out at (ii) to (vi) of Financial Regulation 17;</p> <p>C. the capital programme be amended to reflect the removal of the Property Investment Fund and the Development fund and the addition of the Investment &amp; Development Fund with a budget of £200 million over the period 2018/19 to 2020/21; and</p> <p>D. the amended prudential indicators in Appendix C be approved.</p>
Appendices:	<p>Appendix 'A' – Existing Financial Regulation 17 (page 48)</p> <p>Appendix 'B' - Proposed revisions to Financial Regulation 17 (page 51)</p> <p>Appendix 'C' – Proposed revised prudential indicators (page 55)</p>

## 1. Background

1.1 Following consideration by the Resources Committee on 7<sup>th</sup> February 2017 and 23<sup>rd</sup> March 2017, the Council:

- (i) established a £50 million Property Investment Fund to be utilised for the purchase of land or buildings, with its sole purpose to generate a good return;
- (ii) formed a Council-owned property investment company (Gryllus Property Limited) to enable the purchase of properties outside the District to drive a high level of return (a yield of more than 6%) with money borrowed from the Authority; and
- (iii) established a £20m Development Fund to be utilised to acquire properties within the District which do not drive such a high rate of return but nevertheless would help the Council achieve other corporate objectives, for example regeneration, or to help fund other corporate projects.

- 1.2 The Property Investment Fund and Development Fund are subject to the conditions and the delegation arrangements set out in Financial Regulation 17 at **Appendix 'A'** (page 48). The delegation arrangements agreed were intended to provide the necessary flexibility for acquisitions to proceed without delay and to take advantage of the best commercial opportunities available. It is important to be able to do this if the Council is to be able to operate effectively in a commercial environment.
2. The Property Investment Fund
  - 2.1 The size of the Property Investment Fund established was determined by the amount of income the Council needed to generate, as one component of the Council's Medium Term Financial Strategy, to replace income lost through reduced Government funding, to be able to continue to run good services for residents and businesses.
  - 2.2 In 2017 there was very little property available within the District that would drive a high enough rate of return for the Property Investment Fund. Legal advice is that the purchase of properties outside a Council's own area should be through a Council-owned company, and so Gryllus Property Ltd was set up. In order to provide an appropriate level of elected Member oversight, the company shareholder function was delegated to the Treasury & Investment Sub-Committee (which had originally been established to oversee the Council's financial investments).
  - 2.3 In September 2017 Gryllus acquired its first investment property, a prime retail property at 28 and 30-32 Week Street, Maidstone for a total cost of £3.42m (inclusive of acquisition expenses) with an estimated rental value of £225,000, generating a return on investment of 6.6%. The Council's Property Investment Fund was utilised for this transaction, financed by a loan from the Public Works Loan Board (PWLb) at 2.46% per annum. This leaves £46.6m in the Property Investment Fund for further acquisitions.
  - 2.4 The intention is that Gryllus Property Ltd will build a mixed and balanced portfolio by purchasing property in different sectors (retail, commercial etc) and by spreading purchases across time and geographical area (south and south east England, as property management is also a consideration).
  - 2.5 Almost every other council in Surrey uses some of its borrowing to invest in property to drive income in this way. Some councils have been able to invest in properties within their areas to achieve suitable returns but many have also invested outside their areas to generate the level of income required to support their own financial strategies. Other councils' borrowing and investment was set out in the report to Resources Committee in February 2017 and, in summary, the levels of borrowing for property investment by other Surrey councils are as follows:
    - Elmbridge £17m
    - Epsom & Ewell £26m
    - Guildford £231m (with plans to increase by £337m by 2021/22)
    - Mole Valley £10m (with plans to increase to £50m)
    - Reigate & Banstead – agreement to borrow £80m for property (all purchases currently funded from reserves)
    - Runnymede £199m (with plans to increase to £399m)
    - Spelthorne £418m (including £360m for BP)
    - Surrey County Council £397m
    - Surrey Heath £131m
    - Woking £1bn

### 3. The Development Fund

- 3.1 The Council's Development Fund has so far been called upon to support two purchases within the District; the Village Health Club at Caterham Barracks in connection with the Council's partnership with Freedom Leisure, and Bronzeoak House, Caterham (see report elsewhere on this agenda). Once the latter has been transferred to the HRA, subject to the agreement of this Committee, the Development Fund will stand at just over £19m.

### 4. Proposed Investment & Development Fund

- 4.1 It is now proposed to combine the Property Investment Fund and the Development Fund to create a combined fund and to increase the size of the fund to £200 million. The increase in funding reflects the Council's ambition to acquire properties and support projects that not only drive an income stream but support the regeneration and economic development of the Borough.
- 4.2 There have been a number of changes recently, in both the national and the local landscape, which lead to this proposal.
- 4.3 Firstly, the Government has altered the rules surrounding the use of Public Works Loan Board (PWLB) loans which has led to the Council, together with a number of other councils in Surrey, taking legal advice on whether this may still be used to fund property purchases outside a local authority's own area and if so, what conditions surrounding 'borrowing in advance of need' must be satisfied. This does not affect councils' ability to purchase property outside their own areas per se, as other sources of funding can be used.
- 4.4 Secondly, and more importantly, a significant opportunity to purchase commercial land within the District, which has been the subject of a recent restricted report to the former Resources Committee, is currently being progressed. This opportunity has the potential to create local jobs and boost the local economy, and benefit local businesses and residents, as well as drive a significant financial return for the Council.
- 4.5 If it is agreed that the purchase should go ahead, it will require significant investment in addition to the likely purchase price in order to upgrade and add to the commercial accommodation on the site and drive a high return; early information suggests that a reasonable return might be achieved initially. Whilst the purchase price itself might be met through combining the amounts currently remaining in both the Property Investment Fund and Development Fund, the further investment required necessitates an increase in the combined fund.

### 5. Financial Regulation 17

- 5.1 Subject to the Committee agreeing to combine the Property Investment Fund and the Development Fund, Financial Regulation 17 will need to be amended as shown at **Appendix 'B' (page 51)**.
- 5.2 A further delegation is proposed to allow the phasing of the capital budget to be amended by the Chief Executive, in consultation with the Leader or Deputy Leader and the Chair or Vice Chair of the Strategy & Resources Committee to give the Council the ability to act quickly on property acquisitions if needed (subject to the conditions set out in Financial Regulation 17). This delegation would only apply up to the maximum of the available capital budget.
- 5.3 The Property Investment Fund and the Development Fund, and the combined Investment & Development Fund, relate to acquisitions through the Council's General Fund. It is proposed to extend delegations to the Chief Executive, in consultation with the Leader of the Council and the Chair of the Housing Committee, to allow property up to the same value to be purchased in the Housing Revenue Account (HRA) for the Council's House Building

Programme, subject to the available funds. This will give the ability to respond quickly to opportunities in the future.

- 5.4 When the opportunity to purchase Bronzeoak House in Caterham arose recently, it was purchased using the delegations in the General Fund. A report elsewhere on this agenda proposes that it is transferred to the HRA for the Council's House Building Programme, which in turn will be set out in a report to the Housing Committee on 21<sup>st</sup> June.

## 6. Financial and Risk Implications

- 6.1 The financial implications are set out in the report above.
- 6.2 It is essential that the Investment & Development Fund continues to generate significant additional income for the Council in line with the Medium Term Financial Strategy.
- 6.3 External legal advice will set out the risks of using PWLB loans for property investment purchases outside the District which may lead to a change in strategy concerning sources of funding or for the Council to take steps to justify the use of PWLB funding.
- 6.4 In the meantime, whilst awaiting this advice, there is not likely to be any call on the Property Investment Fund, whilst there is likely to be significant call on the Development Fund. It is therefore recommended that they are combined.
- 6.5 As a result of the proposed increase to the Investment & Development Fund it is necessary to amend the Council's prudential indicators. The prudential indicators set a maximum limit on the amount of external borrowing that cannot be exceeded, and are a guide to the Council's borrowing and investment plans. The amended indicators are set out at **Appendix 'C'** (page 55).
- 6.6 This does not impact upon the yield required for any future acquisitions outside the District, since these will be made through Gryllus Property Ltd and the company requires a return of at least 6%. Properties acquired within the District are likely to require further funding to upgrade or refurbish them before this level of return can be driven.

## 7. Legal Implications

- 7.1 The legal implications are set out in the report above.
- 7.2 The Council's general power of competence under the Localism Act 2011 includes the purchase of land and buildings.

## 8. Equality Impact

- 8.1 The amalgamation of the funds will not place any particular section of the community at a disadvantage. Any proposals for sites acquired using the funds would be subject to further Equality Impact Assessment.

## 9. Conclusion

- 9.1 The Committee is requested to recommend to full Council the amalgamation of the Property Investment Fund and the Development Fund and to increase the size of the fund. Consequential amendments to Financial Regulation 17 are set out at Appendix 'B'. The extension of delegated authority to allow speedy acquisitions in the HRA for the Council's House Building Programme are also set out at Appendix 'B'. The revised prudential indicators are presented at Appendix 'C'.

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**EXISTING FINANCIAL REGULATION 17 – PURCHASE OF LAND AND BUILDINGS UTILISING THE  
PROPERTY INVESTMENT AND/OR DEVELOPMENT FUNDS**

Subject to the conditions below, the Chief Executive, in consultation with the Leader or Deputy Leader can utilise either of the above funds for the purchase of land and buildings for the social, environmental or economic benefit of the area...

		<b>Property Investment Fund</b>	<b>Development Fund</b>
	<b>Size of funds</b>	<b>£50 million</b>	<b>£20 million</b>
		To enable the acquisition of land and buildings for the social, environmental or economic benefit of the area	
(i)	<b>Purpose of funds</b>	To encompass: <ul style="list-style-type: none"> <li>the acquisition of assets, both within and outside the District, to drive income from investment which will support the delivery of services to residents and businesses within the District.</li> </ul>	To encompass: <ul style="list-style-type: none"> <li>the development of Council owned sites within the District; or</li> <li>the acquisition of sites within the District that do not meet the criteria for the Property investment Fund; or</li> <li>other corporate projects</li> </ul>
(ii)	<b>Subject to (iii) to (ix) below, authority is delegated to the Chief Executive, in consultation with the Chair and Vice Chair of the Strategy &amp; Resources Committee to ...</b>	approve the purchase of land and buildings in accordance with the above	<ul style="list-style-type: none"> <li>approve funding to bring forward appropriate Council-owned sites or purchase sites* within the District (that do not meet the criteria for the Property Investment Fund) for development or redevelopment; or</li> <li>support the development of other corporate projects which will:               <ul style="list-style-type: none"> <li>➤ increase capital value of assets; or</li> </ul> </li> </ul>

			<p>➤ provide an improved capital receipt; and / or</p> <p>➤ provide a revenue return or saving for the Council and / or benefit the community (funding for individual projects to be agreed as part of a business plan for the scheme concerned).</p> <p><i>*The Strategic Director of Resources has authority to undertake the necessary investigative, procurement and legal arrangements to facilitate the development of any such sites in accordance with the delegation above.</i></p>
(iii)	<b>Requirement to notify local Ward Members, if contactable during the required timeframe ...</b>	Inform Members if the site concerned is within their Ward	
(iv)	<b>Upper limit on individual purchases ...</b>	Up to £10 million	Up to £5 million
(v)	<b>Upper limit on total sum of purchases ...</b>	£50 million	£20 million
(vi)	<b>Purchase criteria ...</b>	Purchase of such assets and associated income would facilitate or improve the delivery of services to the residents of Tandridge or be of economic benefit to businesses in the Tandridge area	
(vii)	<b>Appraisal requirements ...</b>	<p>(a) an independent R.I.C.S. qualified commercial valuation has been obtained and the purchase price (net of SDLT and VAT):</p> <ul style="list-style-type: none"> <li>• is within the independent R.I.C.S. qualified commercial valuation for the proposed or potential use; or</li> <li>• does not exceed the valuation by more than 15% where an acquisition is being made for future regeneration purposes;</li> </ul>	

		<p>(b) where appropriate, building / mechanical / electrical / lift and environmental surveys</p> <p>(c) the net rental yield (if appropriate) shall represent a reasonable return in light of prevailing market rates; and</p> <p>(d) in order to identify potential Full Life Costs, the valuation has taken account of the condition of the property and where deemed necessary by the Head of Legal Services, an independent building condition survey will be commissioned to inform the Net Rental Yield.</p>	
(viii)	<b>Authority is delegated to the Finance Committee to approve the following in accordance with the above criteria ...</b>	Individual purchases of land or buildings within or outside the District at or above £10 million but less than £20 million in value (including by means of a loan to a Local Authority owned company).	Individual purchases of land or buildings within the District (that do not meet the criteria for the Property Investment Fund) at or above £5 million but less than £10 million in value.
(ix)	<b>Authority is delegated to the Strategy &amp; Resources Committee to approve the following in accordance with the above criteria ...</b>	Approve individual purchases of land or buildings within or outside the District at or above £20 million in value (including by means of a loan to a Local Authority owned company).	Approve individual purchases of land or buildings within the District (that do not meet the criteria for the Property Investment Fund) at or above £10 million in value.

**FINANCIAL REGULATION 17**  
(proposed revised version)

**PURCHASE OF LAND AND BUILDINGS UTILISING THE INVESTMENT & DEVELOPMENT  
FUND OR THE HOUSING REVENUE ACCOUNT (HRA)**

Subject to the conditions specified in Annex 'A' to this Regulation (see next page), the Chief Executive, in consultation with:

- a) the Leader or Deputy Leader and the Chair or Vice Chair of the Strategy & Resources Committee, can utilise the Investment & Development Fund; or
- b) the Leader or Deputy Leader and the Chair or Vice Chair of the Housing Committee, can utilise the Housing Revenue Account

for the purchase of land or buildings in accordance with the Council's general power of competence under the Localism Act 2011, or in the case of the HRA, for the Council's House Building Programme.

Subject to all other conditions specified in Annex A, the Chief Executive, in consultation with the Leader or Deputy Leader and the Chair or Vice Chair of the Strategy & Resources Committee can amend the phasing of the capital budget for the Investment and Development Fund up to the maximum of the available approved funding.



## FINANCIAL REGULATION 17 –INVESTMENT &amp; DEVELOPMENT FUND (proposed revised version)

		Investment & Development Fund	HRA
	<b>Size of funds</b>	<b>£200 million</b>	within the agreed Council House Building Programme for the year
		To enable the acquisition of land and buildings for the social, environmental or economic benefit of the area	
(i)	<b>Purpose of funds</b>	<p>To encompass:</p> <ul style="list-style-type: none"> <li>the acquisition of assets, both within and outside the District, to drive income from investment which will support the delivery of services to residents and businesses within the District;</li> <li>the acquisition of assets within the District that do not meet the level of return required by Gryllus Property Ltd, the Council's arms-length company for the acquisition of assets outside the District;</li> <li>the development of Council owned sites within the District; or</li> <li>other corporate projects</li> </ul>	<p>To encompass:</p> <ul style="list-style-type: none"> <li>the Council's House Building Programme</li> </ul>
(ii)	<b>Subject to (iii) to (viii) below, authority is delegated to the Chief Executive, in consultation with the Leader or Deputy Leader / Leader or Deputy Leader and the Chair or Vice Chair of the Housing Committee, to ...</b>	<ul style="list-style-type: none"> <li>Purchase of land and buildings in accordance with the above;</li> <li>Approve funding to bring forward appropriate Council-owned sites or purchase sites* within the District for development or redevelopment; or</li> </ul>	<ul style="list-style-type: none"> <li>Purchase of land and buildings* in accordance with the above.</li> </ul>

		<ul style="list-style-type: none"> <li>• Support the development of other corporate projects which will: <ul style="list-style-type: none"> <li>➢ increase capital value of assets; or</li> <li>➢ provide an improved capital receipt; and / or</li> <li>➢ provide a revenue return or saving for the Council and / or benefit the community (funding for individual projects to be agreed as part of a business plan for the scheme concerned).</li> </ul> </li> </ul>	
		<i>*The Strategic Director of Resources has authority to undertake the necessary investigative, procurement and legal arrangements to facilitate the acquisition and development of any such land, buildings or sites in accordance with the delegation above.</i>	
(iii)	<b>Requirement to notify local Ward Members, if contactable during the required timeframe ...</b>	Inform Members if the site concerned is within their Ward	
(iv)	<b>Upper limit on individual purchases ...</b>	Up to £10 million	Up to £5 million
(v)	<b>Upper limit on total sum of purchases ...</b>	£50 million per annum	within the agreed Council House Building Programme for the year
(vi)	<b>Purchase criteria ...</b>	Purchase of such assets and associated income would facilitate or improve the delivery of services to the residents of Tandridge or be of economic benefit to businesses in the Tandridge area	
(vii)	<b>Appraisal requirements ...</b>	<p>(a) an independent R.I.C.S. qualified commercial valuation has been obtained and the purchase price (net of SDLT and VAT):</p> <ul style="list-style-type: none"> <li>• is within the independent R.I.C.S. qualified commercial valuation for the proposed or potential use; or</li> <li>• does not exceed the valuation by more than 15% where an acquisition is being made for future regeneration purposes;</li> </ul>	

		<p>(b) where appropriate, building / mechanical / electrical / lift and environmental surveys</p> <p>(c) the net rental yield (if appropriate) shall represent a reasonable return in light of prevailing market rates; and</p> <p>(d) in order to identify potential Full Life Costs, the valuation has taken account of the condition of the property and where deemed necessary by the Head of Legal Services, an independent building condition survey will be commissioned to inform the Net Rental Yield.</p>	
(viii)	<b>Authority is delegated to the Finance Committee to approve the following in accordance with the above criteria ...</b>	...individual purchases of land or buildings within or outside the District at or above £10 million but less than £20 million in value (including by means of a loan to a Local Authority owned company).	not applicable
(ix)	<b>Authority is delegated to the Strategy &amp; Resources Committee / Housing Committee to approve the following in accordance with the above criteria ...</b>	...individual purchases of land or buildings within or outside the District at or above £20 million in value (including by means of a loan to a Local Authority owned company).	Approve individual purchases of land or buildings within the District at or above £5 million in value.

**APPENDIX 'C'**  
to Agenda item 8

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**Indicators of Affordability**

The fundamental objective in the consideration of the affordability of the Council's capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within sustainable limits, and in particular to consider its impact on Council Tax. Affordability is ultimately determined by a judgement about acceptable Council Tax levels and, in the case of the Housing Revenue Account, acceptable rent levels.

**The ratio of financing costs to net revenue stream**

This ratio shows how much of its net revenue expenditure has to be reserved for debt financing costs.

**Affordability Indicator 1 – Ratio of Financing Costs to Net Revenue Stream**

	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund	2.25%	6.84%	21.33%	30.46%
HRA	11.05%	31.28%	25.51%	21.55%

**Estimate of the incremental impact of capital investment decisions on the Council Tax/Housing Rents**

This shows the impact of capital investment decisions on Council Tax/Housing Rents.

**Affordability Indicator 2 – Incremental Impact on Council Tax and Housing Rents**

	2018/19 £	2019/20 £	2020/21 £
Band D Council Tax	15.83	13.80	13.68
Average Weekly Housing Rent	14.86	10.03	9.68

### Estimates and Actual Capital Expenditure

The actual capital expenditure that was incurred in 2017/18 and the estimates of capital expenditure to be incurred for the current and future years are shown below:

#### **Affordability Indicator 3 – Estimates and Actual Capital Expenditure**

	2017/18 £'000 Actual	2018/19 £'000 Estimate	2019/20 £'000 Estimate	2020/21 £'000 Estimate
General Fund	8,342	75,520	65,985	65,675
HRA	6,591	8,950	6,118	3,690
<b>Total</b>	<b>14,933</b>	<b>84,470</b>	<b>72,103</b>	<b>69,365</b>

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### Capital Financing Requirement

This indicator measures the authority's underlying need to borrow for a capital purpose.

#### **Affordability Indicator 4 – Estimates and Actual Capital Financing Requirement**

	2017/18 £'000 Actual	2018/19 £'000 Estimate	2019/20 £'000 Estimate	2020/21 £'000 Estimate
General Fund	7,467	82,232	147,582	212,712
HRA	56,539	55,289	55,539	51,989
<b>Total</b>	<b>64,006</b>	<b>137,521</b>	<b>201,121</b>	<b>264,701</b>
<b>Movement in CFR</b>	<b>13,554</b>	<b>73,515</b>	<b>63,600</b>	<b>63,580</b>

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**Authorised limit**

In respect of any external debt, it is recommended that Members approve the following authorised limits for its total external debt for the next three financial years; these figures take account of the potential requirement of both the HRA and General Fund. There are currently no other long term liabilities such as finance leases.

The Head of Finance & S151 Officer reports that these authorised limits are consistent with the authority's current commitments and the self-financing arrangements for the HRA.

The increases proposed are solely to support income generating activities and invest-to-save projects (e.g. Property investment). The costs of this borrowing will be more than met by the income streams created or the savings generated.

**Affordability Indicator 5 – Authorised Limits for External Debt**

	2018/19 £'000	2019/20 £'000	2020/21 £'000
Borrowing	270,000	270,000	270,000
Other Long Term Liabilities	0	0	0
<b>Total</b>	<b>270,000</b>	<b>270,000</b>	<b>270,000</b>

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**Operational boundary** – Members are also asked to approve the following operational boundary for external debt for the same time period. The operational boundary represents a key management tool for in year monitoring by the Head of Finance & S151 Officer. Within the operational boundary, figures for borrowing and other long term liabilities are separately identified.

**Affordability Indicator 6 – Operational Boundary for External Debt**

	2018/19 £'000	2019/20 £'000	2020/21 £'000
Borrowing	265,000	265,000	265,000
Other Long Term Liabilities	0	0	0
<b>Total</b>	<b>265,000</b>	<b>265,000</b>	<b>265,000</b>