

**ESTABLISHMENT OF A LOCAL AUTHORITY PROPERTY TRADING COMPANY
AND INCREASING THE COMMERCIAL PROPERTY ACQUISITION FUND**

Report of the: Chief Executive
Contact: Kathryn Beldon, Rod Brown, Lee Duffy,
Mark Shephard, Simon Young
Urgent Decision?(yes/no) No
If yes, reason urgent decision required: N/A
Annexes/Appendices (attached): None
Other available papers (not attached): None stated

REPORT SUMMARY

This report outlines a proposal to establish a company or companies to acquire, hold and trade in property, seeks to establish a working group with member representation, and seeks authority for officers to incur such costs relating to necessary advice and assistance to enable proposals to be brought back for subsequent approval.

The report also outlines and recommends an increase to the Commercial Property Acquisition Fund with a further addition of £60m to be funded from Prudential Borrowing.

RECOMMENDATION (S)

It is recommended that the Committee:

- (1) Notes and agrees in principle to the establishment of a company or companies to acquire, hold and trade in property.**
- (2) Agrees that a working group be established comprising the Chief Executive and other Officers listed at the top of this report together with the Chairman of the Strategy & Resources Committee and the Vice-Chairman of the Community & Wellbeing Committee for the purposes set out in the report below.**
- (3) Agrees that any of the Member appointed to the working group who is unable to attend a meeting of the working group shall be able to nominate another Member of the Council to substitute for them.**

Notes

- (4) Agrees that an initial budget of £50k be established to meet the costs of procuring specialist legal, financial and other necessary professional advice and set up costs.**
- (5) Agrees to recommend that Council increase the Commercial Property Acquisition Fund by a further £60m to be funded by Prudential Borrowing.**
- (6) Agrees to recommend to Council a supplementary capital expenditure estimate of £60m in financial year 2016/17 for (5) above.**
- (7) Agrees to recommend to Council that the Council's Prudential Indicators be revised to reflect the additional £60m of Prudential Borrowing.**
- (8) Notes that a mid-year appraisal update report will be made to the Committee on the strategy, portfolio performance and status of acquisitions made from the Commercial Property Acquisition Fund.**
- (9) Notes that a new regular update report will be made to the Financial Policy Panel on the financial status of the investment property portfolio and rental income profile.**

1 Implications for the Council's Key Priorities, Service Plans and Sustainable Community Strategy

1.1 The Council's vision of making Epsom & Ewell an excellent place to live and work requires sufficient resource in order to deliver services. Managing our resources is a key priority. One of the ways we seek to do this is by maximising returns from our properties and other investments. This report proposes work towards the establishment of a company to do just that, as set out in the body of the report.

2 Background

2.1 The Council currently receives rental income streams from properties we lease to business and other organisations. It is considered that there is significant scope to grow this revenue income stream by using prudential borrowing to acquire further properties in line with the Council's property investment strategy which aligns with the social and economic needs of the Borough.

2.2 Acquisition of properties in the Borough can also help the Council to promote the local economy, by ensuring that sufficient opportunities remain for businesses to start-up and grow.

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- 2.3 Revenue Support Grant funding from Central Government has reduced substantially in recent years, and the outlook is not promising in that regard. The Council's published Medium Term Financial Strategy and Efficiency Plan projects a current deficit position for the Council up to 2019/20. The Council can potentially generate additional funding from Business Rates, Council Tax and fees & charges, but the scope to do so is limited, and will not itself ensure financial stability. Whilst further savings can be made, again, the scope for this is considered to be fairly limited. We therefore need to look for other ways to support service delivery and generate on-going revenue streams.
- 2.4 On 21 November 2016, the Council agreed to create a £20million Commercial Property Acquisition Fund to enable the Council to acquire additional commercial investment properties located within the Borough, with a view to generating long term revenue streams. This will assist in supporting the delivery of Council services and strengthen the Council's long term financial stability.
- 2.5 As the Council's property holdings grow, there is a need to create a balanced portfolio, in order to better manage the risks associated with investment properties. The risks can include too great an exposure to a particular location or type of property, the risks of voids between leases, and risks relating to repair & maintenance of the structure and plant associated with specific buildings.
- 2.6 Purchasing commercial or residential investment property in areas outside the Borough is an acknowledged business activity i.e. trading in the property market for income – where there is no clear direct benefit to the Borough. The Council has the power to trade in this manner, but must essentially do so via a Local Authority Trading Company (LATC). This is a company that operates as a separate entity to the Council but is wholly owned by the Council.
- 2.7 As the Council is itself a local housing authority, and does not have its own housing stock, it cannot generally own and let residential properties except on secure tenancies, which carry with them certain rights, such as the right to buy (there are exceptions in the case of, for example, the sort of temporary accommodation for homeless persons we currently hold).
- 2.8 There is a significant shortage of affordable housing within the borough with approximately 120 households in a range of temporary accommodation within the borough and approximately 40 households living in out of borough bed and breakfast accommodation. The future supply of new affordable housing is limited and is not expected to meet future or current demand, resulting in continuing significant expenditure on homelessness.

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- 2.9 It is also worth noting that, at the time of writing, there are over 2000 people on our housing needs register. Whilst we are currently going through an exercise to review all those on the register, it is expected that after the review we could possibly still have up to 800 people registered. This represents individuals and families all of whom are looking for and have a need for suitable affordable housing.
- 2.10 Where, as part of establishing our balanced property portfolio we may wish to consider holding residential properties for general market rent (as well as affordable properties), we would need to hold those properties via a LATC.
- 2.11 Depending on how they are established, LATCs can potentially operate free of many of the restrictions which can hamper the ability of the Council to react quickly to opportunities and procure works, goods and services. As the LATC is wholly owned by the Council it can also use borrowing available from the Public Works Loan Board but this would be charged by the Council to the LATC at “market rate” as otherwise this could be viewed as “state aid”. It should be noted however that any borrowing solely for Affordable Housing could be at less than market rate as this is not considered as an activity which is commercially related.
- 2.12 It is important to note that any support provided by the Council to the LATC could be viewed as anti-competitive under current EU rules and so the LATC is likely to be required to pay “commercial rates” for all staff time, premises, finance, payroll, I.T. support it received from the Council itself.
- 2.13 Whilst it is straightforward to register a company at Companies House, a great deal of work and due diligence is required before the Council can decide what sort of entity or entities to create, and establish the governance arrangements of such entities. We also need to decide how the LATCs will be financed and resourced again, loans at a commercial rate from the Council will be required, which in turn will require borrowing to invest decisions by the Council and consideration of the effects on the Medium Term Financial Strategy and Efficiency Plan.

3 Proposals

- 3.1 It is proposed that a working group be established comprising the Chief Executive, Director of Finance & Resources and the Heads of Legal & Democratic Services, Property and Housing & Environmental Services, together with the Chairman of Strategy & Resources Committee, and also the Vice-Chairman of the Community & Wellbeing Committee – the latter in particular because of likely proposals in respect of the provision of housing, which is within the remit of that Committee.
- 3.2 The working group will consider, for example,
- 3.2.1 The issues and options surrounding the creation of a LATC or group of LATCs

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- 3.2.2 What structure will be established – single LATC or several independent LATCs or a group of LATCs
 - 3.2.3 What shareholder arrangements should be made;
 - 3.2.4 What the composition of the board of directors should be;
 - 3.2.5 The appropriate governance arrangements to ensure robust and efficient reporting between the LATC and the Council;
 - 3.2.6 How the LATC or LATC's will be financed (via loans from the Council and/or other public or private sources of funding);
 - 3.2.7 And all other issues which are identified
- 3.3 It is expected that the working group will obtain and consider all appropriate professional advice, and will agree a report with recommendations for the Strategy and Resources Committee to consider at a later date.
- 3.4 It will be important that a robust business case is made out before any companies are established, and, in order to ensure that all the necessary issues are considered, specialist advice will be required. This will comprise legal advice, financial advice and other specialist advice, depending on what is proposed.
- 3.5 In due course a further report will be brought to Committee seeking approval to the establishment of a company or companies, where it is considered to be in the best interests of the Council to do so.

4 Commercial Property Acquisition Fund

- 4.1 On 21 November 2016 Council agreed the Property Investment Strategy 2016-17 and the creation of a Commercial Property Acquisition Fund with a fund limit of £20m financed from Prudential Borrowing.
- 4.2 Since the creation of the fund, the Council has completed on the acquisition of an office building and is under offer on a further investment opportunity. It is therefore considered likely that the fund will be exhausted by February 2017 and well before the end of this financial year.
- 4.3 This leaves no working fund or flexibility to fund or even negotiate on future acquisitions and leaves the Council in a position where it cannot act quickly on property investment matters if it has to wait for further approvals of funding from this, or other Committees.
- 4.4 It is therefore proposed that a further amount of £60m be recommended to Council by this Committee to ensure the fund has sufficient financial standing for potential new acquisitions.

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- 4.5 It is critical to note that any potential purchase will follow exactly the same robust scrutiny process that existed for the initial £20m as approved by Extraordinary Council on 21 November 2016. Each acquisition will be in compliance with the Property Investment Strategy 2016-17 and thereby subject to its investment criteria scoring matrix. A full supporting business case including risk, legal and financial analysis will be required and approved by the dedicated Investment Property Group (IPG) of the Council. The IPG comprises the Chairman and Vice-Chairman of the Strategy & Resources Committee together with the Chief Executive, Director of Finance & Resources and the Heads of Financial Services, Property and Legal & Democratic Services.
- 4.6 It is also proposed to provide this Committee with a new mid-year update report on the strategy, status, and portfolio performance of the Commercial Property Acquisition Fund which will also be available for scrutiny by the Council's auditors. This will further strengthen the governance and internal control arrangements around the fund and the processes for making acquisitions.
- 4.7 Similarly, it is proposed to introduce a new regular report to the Financial Policy Panel on overall property investment performance and rental income profile. This will also include updates on the provisions that the Council will be setting aside as a contingency against future voids and enhancement costs associated with the acquired properties. The funding of these provisions will be created by prudently setting aside an element of the net revenue streams that arises from the rental income from each property.
- 4.8 If an additional £60m is approved for the fund then this will increase the overall fund limit to a value of £80m and this would again be funded from Prudential borrowing by way of loans from the Public Works Loan Board.
- 4.9 It should be noted that although the limit has been increased to £80m this does not necessarily mean that the full £80m will be spent, it is a limit only and specific recommendations for any acquisition will follow the strict criteria outlined in 4.5. above. It is standard practice for Councils to ensure they have sufficient "headroom" limits for prudential borrowing to avoid having to make repeated requests to Council for smaller incremental increases, which could, for example slow down or lose a potential acquisition if a month say, is lost waiting for funding approval. To provide the additional borrowing of £60m it will be necessary to amend the Council's prudential indicators and this change can only be made by full Council. It is therefore proposed that this will be recommended to the next meeting of Full Council on 14 February 2017.
- 4.10 It is essential that any future borrowing is affordable and within the limits of Prudential Borrowing and parameters of the Medium Term Financial and Efficiency plan of the Council.

5 Financial and Manpower Implications

- 5.1 It is considered appropriate to establish an initial budget of £50k for the feasibility work required for establishing a potential LATC. This will be funded from a one off contribution from the rental income that has been accumulated from the purchase of properties within the Commercial Property Acquisition Fund to date in financial year 2016/17. This feasibility work will determine the costs versus benefits of operating a LATC for this Council.
- 5.2 The additional borrowing of £60m will be provided and funded by Prudential Borrowing. The Prudential Indicators for the Council determine whether this is affordable and prudent and revised Indicators will be presented to Council for final approval.
- 5.3 All Council property acquisitions are subject to a full business case to ensure financial viability before they are agreed by the Investment Property Group.
- 5.4 Borrowing rates are currently at historic lows and it is estimated that over the next two years the cumulative borrowing levels of all Surrey Councils will reach £2 billion. Due to reductions in Revenue Support Grant and New Homes Bonus, most Surrey Councils are actively seeking additional revenue income streams from capital property assets to help fund their budgets and projected gaps in funding.
- 5.5 **Chief Finance Officer's comments:** *The Council has taken advice from the Council's treasury advisors on the potential borrowing implications for the Commercial Property Acquisition Fund. Professional finance advice will be obtained in relation to the creation of any LATC and this will be reported to this Committee before any final decision is made to form a LATC. The Council's Medium Term Financial Strategy and Efficiency Plan reflects a deficit position to 2019/20 and net revenue streams generated from property rental income streams will help bridge the Councils negative funding position. There will be mid-year reports made to this Committee to appraise the position and performance of the Commercial Property Investment Fund.*

6 Legal Implications (including implications for matters relating to equality)

- 6.1 **Monitoring Officer's comments:** *The Council has power to trade, and to establish a Local Authority Trading Company to do so, under a range of legislation. There are no direct legal implications arising from this report – such issues will need to be identified and addressed as part of the work of the proposed Working Group.*

7 Sustainability Policy and Community Safety Implications

- 7.1 There are no sustainability or community safety implications arising from this report.

8 Partnerships

8.1 There are no implications for partnerships arising from this report.

9 Risk Assessment

9.1 There are no significant risks arising from this report. The risks relating to the establishment and operation of a company or companies will be considered as part of the work of the proposed Working Group and will be considered when the matter is brought back for a future decision.

10 Conclusion and Recommendations

10.1 In conclusion it is considered that the potential benefits of establishing a company or companies are considerable. This is something many other authorities have done to great effect, including Surrey County Council and several Boroughs and Districts in the County. Accordingly, it is considered worthwhile investing in exploring our options, in order to establish arrangements which will work to best effect for the residents of Epsom & Ewell and will support the Council in delivering valued services in future years.

10.2 It is expected that the Council will have committed the majority of the approved £20M borrowing before the end of this financial year. The commercial property market is fast moving, and there are opportunities to grow our investment property holdings. In accordance with the approved investment criteria matrix of the Property Investment Strategy 2016-17, we will only consider high scoring properties where the full business case favours acquisition. The sooner we make acquisitions, the sooner we will be able to reap the benefits of the accompanying rental income. It is therefore also proposed that we increase our borrowing ceiling, in order to facilitate further acquisitions.

WARD(S) AFFECTED: (All Wards);