Public Document Pack

EPSOM & EWELL

TOWN HALL

EPSOM

11 November 2016

SIR OR MADAM

I hereby summon you to attend an Extraordinary meeting of the Council of the Borough of Epsom and Ewell which will be held at the Town Hall, The Parade, Epsom on **MONDAY, 21 NOVEMBER, 2016** at **7.30 pm**. The business to be transacted at the Meeting is set out on the Agenda overleaf.

S Young

Head of Legal and Democratic Services

COUNCIL

Monday 21 November 2016

7.30 pm

Council Chamber - Epsom Town Hall

For further information, please contact Fiona Cotter,
tel: 01372 732124 or email: fcotter@epsom-ewell.gov.uk

FIRE PRECAUTIONS

No fire drill is planned to take place during the meeting. If an alarm sounds, members of the public should leave the building immediately, either using the staircase leading from the public gallery or following other instructions as appropriate. Do not use the lifts.

On leaving the building, please make your way to the Fire Assembly point on Dullshot Green.

AGENDA

1. DECLARATIONS OF INTEREST

To receive declarations of the existence and nature of any Disclosable Pecuniary Interests from Members in respect of any item to be considered at the meeting.

2. COMMERCIAL PROPERTY ACQUISITION FUND (Pages 5 - 26)

This report presents the Property Investment Strategy 2016-17 and seeks to create a £20m Commercial Property Acquisition Fund resourced from prudential borrowing. It will enable the Council to acquire additional commercial property investments located within the Borough with a view to generating long term secure income streams.

It will assist in supporting the delivery of future Council services and strengthen its long term financial stability

3. **EXCLUSION OF PRESS AND PUBLIC** (Pages 27 - 28)

The Committee is asked to consider whether it wishes to pass a resolution to exclude the Press and Public from the meeting in accordance with Section 100A (4) of the Local Government Act 1972 on the grounds that the business involves the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A to the Act (as amended) and that pursuant to paragraph 10 of Part 2 of the said Schedule 12A the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

4. **COMMERCIAL PROPERTY ACQUISITION** (To Follow)

This report has not been published because the meeting is likely to be closed to the press and public in view of the nature of the business to be transacted/nature of the proceedings. The report deals with information relating to the business affairs of the Council and the public interest in maintaining the exemption currently outweighs the public interest in disclosing the information.

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COMMERCIAL PROPERTY ACQUISITION FUND

Report of the:	Chief Executive
Contact:	Kathryn Beldon/Lee Duffy/Brian Thompson Mark Shephard/Simon Young
Annexes/Appendices (attached):	**Annexe 1** - Property Investment Strategy 2016/17 **Annexe 2** - Revised Prudential Indicators 2016/17 **Annexe 3** - IPD UK Annual Property Index
Other available papers (not attached):	None stated

REPORT SUMMARY

This report presents the Property Investment Strategy 2016-17 and seeks to create a £20m Commercial Property Acquisition Fund resourced from prudential borrowing. It will enable the Council to acquire additional commercial property investments located within the Borough with a view to generating long term secure income streams.

It will assist in supporting the delivery of future Council services and strengthen its long term financial stability.

RECOMMENDATION (S)	*Notes*
(1) That Council endorse the Property Investment Strategy 2016-17 attached at Appendix A for all commercial property investment acquisitions. **(2) That Council approve the creation of a Commercial Property Acquisition Fund of up to £20m, financed from prudential borrowing in 2016/17 and future years.** **(3) That Council approve the creation of a dedicated Investment Property Group (IPG) with delegated authority to make all property investment decisions in compliance with the Property Investment Strategy.**	

(4) That Council approve supplementary capital expenditure for property acquisitions of up to £20m based upon £20m of borrowing commencing in 2016/17 (for economic and social wellbeing purposes and to generate on-going revenue streams). **(5) That Council approve the revised set of prudential indicators which include the operational boundary and authorised limit for external borrowing; these indicators supersede those in the Council's existing Treasury Management Strategy approved by full Council on 19 April 2016.**	

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

1.1 Managing our Resources

- Maximising returns from properties and other investments
- Identify new sources of revenue and maximising our existing income

1.2 Supporting Businesses and our Local Economy

- Supporting developers to bring forward the development of town centre sites

2 Background

2.1 Advised by the Financial Policy Panel at its 27 September 2016 meeting, the Strategy & Resources Committee approved the recommendation that Council accepts the four year funding settlement from Central Government.

2.2 A widely expected phased cut to funding was front loaded and leaves the Council with no Revenue Support Grant (RSG) from 2017/18 onwards, and an overall 66% reduction in funding between 2015/16 and 2019/20.

2.3 Whilst the four year settlement is unfavourable it does provide Councils with a platform from which to plan for the future. The risk of not accepting the settlement would have been to expose the Council to the uncertainty of even greater cuts.

2.4 The acceptance of the settlement still leaves the Council with an anticipated budget shortfall in 2017/18 through to 2019/20 (as previously reported to Council Members). The reductions in RSG have been on-going for a number of years, and this combined with the need to "stand on its own two feet" financially, means it is imperative that the Council focuses on the most effective ways of increasing long term sustainable income sources.

2.5 By way of example, the Council established a £3m Residential Property Acquisition Fund at the beginning of this year (approved at Strategy & Resources Committee on 27 January 2016). We are in the process of acquiring our first properties using this fund. Purchased properties will be used for temporary accommodation which provides a reduction in temporary accommodation costs as well as generating an income stream with long term capital growth prospects.

2.6 The Council currently has a small portfolio of properties, from which it currently derives rental income of around £1.1million. This report proposes a step change to the role of income from properties in helping to fund the delivery of services valued by residents.

3 Commercial Property Acquisition Fund

3.1 The Council now has an opportunity to address these issues through the creation of a £20m Commercial Property Acquisition Fund to exploit commercial property investment opportunities and improve the social and economic wellbeing within the Borough. The property acquisitions, financed from prudential borrowing, will generate long term rental income streams to replace lost RSG funding and assist the Council "stand on its own two feet" financially. It will also facilitate longer term regeneration objectives.

3.2 The Council will borrow from the Public Works Loan Board (PWLB) – a statutory body operating within the UK Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities for their specific needs in line with their affordability.

3.3 Councils are in a strong financial position to acquire property due to their ability to access capital, coupled with the low cost of borrowing.

4 Property Investment Strategy ("the Strategy")

4.1 The Property Investment Strategy 2016-17 (Appendix A) provides a robust and viable framework for the acquisition of commercial property investments. It is designed to stand alongside the Council's existing Asset Management Plan 2012-16 which sets out how property assets are appropriately managed long term.

4.2 The three underlying objectives of the Strategy are to define investment criteria, manage risk and provide an agile decision making framework.

4.3 The Strategy seeks a balanced return from a diversified commercial property portfolio. The preference is towards high quality buildings in good locations with financially strong tenants. A scoring Matrix allows the relative merits of an investment opportunity to be measured and assessed against a target threshold.

4.4 A long term approach to risk management will be adopted by holding property assets for a minimum 50 years (as most properties will have residential potential if their current use becomes obsolete). This will ensure income and capital returns are considered over the long term thereby smoothing out any cyclical economic / property downturns.

4.5 The Council will borrow from the Public Works Loan Board (PWLB). The PWLB offer historically low fixed interest rates (Epsom & Ewell can borrow at circa 2.5% based on rates at this date) thereby protecting the Council from any future increases in financing rates.

4.6 The availability of suitable high quality, low risk investment property is generally limited, and consequently, can generate strong competition when opportunities arise.

4.7 For the Council to compete in the property investment market place, it is essential for it to be able to respond swiftly and decidedly. To accommodate this necessary level of commercial agility, it is recommended that delegated authority to make decisions be given to a dedicated Investment Property Group (IPG). The IPG membership will include the Chairman and Vice-Chairman of the Strategy & Resources Committee together with the Chief Executive, Director of Finance & Resources and relevant Heads of Service (Property, Legal and Financial).

4.8 For a potential property investment to be considered by the IPG, it must achieve a minimum weighted score of 60 (out of a possible 100) from the scoring Matrix. It must also be accompanied by a full business case.

4.9 The business case will be prepared by the Head of Property in consultation with finance and legal colleagues. Each potential property investment will undergo qualitative and quantitative appraisal to establish portfolio suitability and the legal / financial implications of the purchase. The Head of Property will seek external investment / technical expertise where specialist property market knowledge is required.

4.10 All acquisitions will be subject to building survey, purchase report and valuation. In view of the potential value of acquisitions, it is envisaged that the Council will be externally represented for each transaction by a property investment agent and legal firm.

5 Financial and Manpower Implications

5.1 Councils are in a strong financial position to acquire property to safeguard the economic wellbeing of their Boroughs due to their ability to access capital, coupled with the current low cost of borrowing. For example, the Council is able to borrow externally from the PWLB at “certainty” rates of circa 2.5% (as at today’s date). This would be based on a “Maturity” repayment loan (which is a loan repayable in full at the end of its term / maturity).

5.2 In the current climate it is considered prudent to borrow money at these rates (which are at a historic low) rather than rely on already depleted (and mostly committed) levels of capital receipts and/or other sources of restricted capital funding.

5.3 Historically this Council has been debt free, as have others in Surrey. However, in the current fiscal climate most Local Authorities are now increasingly looking to borrow to fund property purchases which attract an on-going income stream and stimulate regeneration and economic development. It is estimated that over the next two years the collective cumulative borrowing levels of all the Surrey Districts and Boroughs will reach nearly £2bn for reasons outlined above in 5.1 and 5.2.

5.4 Councils are able to set whatever borrowing limit they judge to be appropriate. However, under the Prudential Borrowing rules it clearly needs to be prudent and affordable. Importantly, EEBC will need to consider carefully the impact of increasing levels of debt, and its ability to repay the principal element of the loan/s.

5.5 Officers have sought specialist borrowing advice from the Council's Treasury Management advisors; Capita, who are comfortable with the level of borrowing required to sustain a supplementary capital estimate of £20m. They have also recommended that Council does not borrow from the PWLB until a business case is completed, the final acquisition is confirmed and then the physical cash requirement is determined. Accessing borrowing from the PWLB is a fairly straightforward process and can be done within a short notice period (less than a few days) for these levels of borrowing. Capita have also suggested that the Council consider internal borrowing for some of its property acquisitions and this is discussed in para 5.8 below.

5.6 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 are included in the Council's Treasury Management Strategy that was approved by Council on 19 April 2016. These therefore need to be revised, and an updated set are included at Appendix B for Council approval.

5.7 If the additional capital estimate is agreed, the capital programme will increase in 2016/17 from £1,031,000 to £21,031,000 (reflecting the increase of £20m in this report. As a result, the capital financing requirement (which represents the amount of money needed to fund the new expenditure) and the operational boundary (which is the anticipated maximum level) for external debt in 2016/17 will increase to £20m. In order to cover unexpected eventualities outside the remit of this specific report and 'just in case' scenarios on cash flow fluctuations, it is also deemed prudent to increase the authorised limit for external debt (which is the absolute limit the Council must not go beyond) to £25m. This is purely to provide a safety net for the Council and to minimise risk.

5.8 Whilst external PWLB Borrowing would be the usual vehicle of choice for funding acquisitions it is possible for the Council to use an “internal borrowing” strategy to fund part of the £20m expected capital spend on the property acquisitions. The purpose of internal borrowing is to “address the cost of carry” that the Council would have. In plain speak this can be explained as follows; the Council has short term cash investments of £15m (as detailed in the Council’s 2016/17 published Statement of Accounts) which earn on average 0.90% interest as rates are low at the current time. So, rather than borrow from the PWLB at a rate of 2.5%, the Council could choose to re-direct some of these internal monies to fund the capital expenditure for the property acquisitions and thus save interest costs. However, it should be noted that this is a short term solution only as if investment interest rates rise in the future (or PWLB rates decrease) then the positon would be reversed and a switch to PWLB borrowing would be more cost effective.

5.9 The decision to fund internally or externally would have to be made on a “case by case” basis and take into account market factors and the overall financial positon of the Council in terms of its cashflow and short term investment position. Therefore, for the purposes of this report, it is suggested that this is something considered alongside each specific potential purchase on a cost/benefit analysis basis.

5.10 ***Chief Finance Officer’s comments:*** *The financial and borrowing implications for creation of the Commercial Acquisition Fund are laid out and explained in the Financial Implications above.*

5.11 *The Council has taken advice from its Treasury Advisors; Capita, in respect of the borrowing implications for the Council and the capital implications of this decision.*

5.12 *As the Council moves from debt free status to a Council with Prudential Borrowing requirements, it will be taking further advice from Capita on its debt management and borrowing requirements and subscribing to their service for this will cost an additional £2k per year which will be funded from existing budgets.*

5.13 *The effects of borrowing in terms of the Minimum Revenue Provision (the amount that has to be set-aside for debt repayment purposes and is chargeable to the Council Tax payer) will be built into the Council’s Budget Plans for 2017/18 and onwards and reported to Council.*

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

6.1 Pursuant to Section 120 of the Local Government Act 1972 the Council has the power to acquire any land for the purpose of carrying out its functions or for the benefit, improvement or development of the area.

6.2 Section 12 of the Local Government Act 2003 provides a power to the Council to invest a) for any purpose relevant to its functions, or b) for the purposes of the prudent management of its financial affairs. This includes investment in property if it relates, for example, to the economic wellbeing of the Borough (including the regeneration of a town centre).

6.3 Section 1 of the Local Government Act 2003 provides a power to the Council to borrow a) for any purpose relevant to its functions, or b) for the purposes of the prudent management of its financial affairs.

6.4 The Council also has a general power of competence under Section 1 of the Localism Act 2011 to do anything that individuals generally may do. This includes the power to undertake any activity that will support the social, economic or environmental wellbeing of the Borough.

6.5 ***Monitoring Officer's comments:*** *The proposals in this report are considered to fall squarely within the Council's powers. The governance arrangements around the Property Investment Strategy are considered to be sufficient to protect the Council's interests.*

7 Sustainability Policy and Community Safety Implications

7.1 None for the purpose of this report.

8 Partnerships

8.1 None for the purpose of this report.

9 Risk Assessment

9.1 As an asset class property investment provides a better total return (i.e. from both income and capital appreciation) than cash investments, whilst still maintaining a high level of security.

9.2 The Investment Property Databank (IPD) Index tracks retail, office and industrial properties. The Index includes data on actual property transactions from institutional investors and property companies. It produces annual and monthly figures for the total return. The IPD Index is the standard benchmark for investors to analyse the UK commercial property market. In addition, comparable return and risk analysis is provided for other types of investments – bonds and general equities.

9.3 The 2015 IPD UK Annual Property Index (results for the year to 31 December 2015) is attached at Appendix C and recorded a total all property return of 13.1%; split approximately between an income return of 4.8% and a capital return of 8%. In contrast over the same period, bonds returned 1% total return, equities (shares) returned a negative -2.2% and inflation was 1.2%.

9.4 Historically, the All Share Index has returned a dividend yield (i.e. income yield) of approximately 3.5% pa. The negative total return of -2.2% for 2015 was attributable to negative capital growth. It is widely expected the total return for equities in 2016 will be positive.

9.5 IPD calculations confirm that investing in property has the second lowest risk (after bonds) as measured by volatility (standard deviation). Furthermore, commercial property is often viewed as a hybrid asset class in that it exhibits the income security of bonds with capital growth prospects more associated with shares.

9.6 Investment in property is deemed illiquid, that is, invested money cannot normally be accessed at short notice. However, this complements the Property Investment Strategy which specifically adopts a 50+ year investment horizon. This will ensure income and capital returns are considered over the long term thereby smoothing out any cyclical economic / property downturns.

9.7 The Council will borrow from the Public Works Loan Board (PWLB) at historically low fixed interest rates of circa 2.5% - this will protect the Council from any future increases in financing rates.

9.8 All potential property investments will be risk assessed against the Scoring Matrix and mitigated by the proposed governance arrangements.

9.9 Risk will be continually monitored and mitigated as follows:-

Risk	Level	Mitigation
Poor investment decision making.	L	Each investment acquisition will be Matrix scored and include a full business case.
Consequences of proposed investment decisions on borrowing.	L	The Council is required to have regard to CIPFA's Prudential Code for Capital Finance governing borrowing decisions. Revised Prudential indicators are attached at Appendix B.
Economic slowdown in the property market making transactions difficult to complete.	M	Agile governance structure proposed (IPG) to allow the Council to take advantage of prevailing market conditions.
Lack of suitable property investment opportunities in the Borough.	M	The Head of Property will build relationships with local and regional investment agents.
Property values can go down as well as up.	L	Long term holding strategy at fixed loan rates will smooth out market cycles.

Risk	Level	Mitigation
Vacancies – due to tenant going into liquidation / administration or leases not renewed at expiry.	M	Attractive buildings in good locations will assist the re-letting of empty buildings.
Investment opportunities are lost as the Council is unable to act swiftly and decidedly.	L	IPG to be established under the Property Investment Strategy governance arrangements.
Investments are acquired without full knowledge of building or tenant lease obligations.	L	A thorough legal and practical due diligence process will be undertaken.

Key: L – Low; M – Medium; H - High

10 Conclusion and Recommendations

10.1 For services to be maintained at their current levels, it is recognised that the Council must not only continue to identify ongoing operational efficiencies, but also to seek new long term sustainable income sources.

10.2 It is proposed that Council endorse the Property Investment Strategy 2016-17 attached at Appendix A.

10.3 It is further proposed that a £20m Commercial Property Acquisition Fund be established by the Council to exploit commercial property investment opportunities in the Borough. The property acquisitions, financed from prudential borrowing, will generate long term rental income streams to replace lost Revenue Support Grant funding.

10.4 For the Council to compete in the property investment market place, it is essential for it to be able to respond swiftly and decidedly. To accommodate this necessary level of commercial agility, it is proposed that delegated authority to make decisions be given to a dedicated Investment Property Group (IPG) acting in accordance with the Property Investment Strategy 2016/17.

10.5 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 are included in the Council's Treasury Management Strategy that was approved by Council on 19 April 2016. It is proposed the revised prudential indicators included at Appendix B are approved.

WARD(S) AFFECTED: All

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Epsom and Ewell Borough Council
Property Investment Strategy

2016/17

November 2016

Introduction

The Property Investment Strategy ("the Strategy") aims to provide a robust and viable framework for the acquisition of commercial property investments. The three underlying objectives of the Strategy are:-

- **Investment Criteria** – to identify suitable property investment opportunities.
- **Risk Management** – to balance the requirement for income return with an acceptable level of managed risk.
- **Governance Arrangements** – to provide an agile decision making framework.

The asset management of the Council's existing property estate (comprising operational and commercial investment properties) is defined in the Asset Management Plan (AMP). The AMP will subsequently apply to all property investments acquired under this Strategy to ensure that assets are appropriately managed long term.

Investment Criteria

In common with all forms of investment at their most basic level, property investment is a trade-off between risk and return. A traditional well diversified property portfolio (spread across different property sectors and geographical regions) will deliver a balanced long term return with minimal risk. It will typically provide a steady income yield of 5%-7% with the additional prospect of capital growth.

The Strategy will adopt the same underlying principle of diversification in acquiring a Borough wide portfolio of property investments offering a similar income yield profile. The three main property sectors will be included (industrial, office and retail) and in turn, these will be diversified on criteria including location, the tenant's financial (covenant) strength, lease term (income duration) and investment lot size. This will ensure that should a property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant), then the loss of income will not adversely affect the portfolio's return.

A scoring Matrix allows the relative merits of an investment opportunity to be measured and assessed against a target threshold. The Matrix is attached at Appendix A and includes the following scoring criteria:-

- **Location** - property is categorised as either prime, secondary or tertiary in terms of its locational desirability. For example, a shop located in the best trading position in a town would be prime, whereas a unit on a peripheral neighbourhood shopping parade would be considered tertiary.

- **Tenant Covenant** – the financial strength of a tenant determines the security of the property's rental income. A financially weak tenant increases the likelihood that the property will fall vacant. The minimum acceptable financial strength for any given tenant will be determined through financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. To minimise management and risk, the preference will be for single occupancy investments wherever possible.

- **Building Quality** – a brand new or recently refurbished building will not usually require capital expenditure for at least 15 years. This is attractive for income investors requiring long term rental income with the minimum of ongoing capital expenditure.

- **Occupational Lease Length** – the lease term will determine the duration of the tenant's contractual obligation to pay rent. The most attractive investments offer a long lease with a strong tenant covenant.

- **Tenure** – anything less than a freehold acquisition will need to be appropriately reflected in the price.

- **Tenant Repair obligations** – under a Full Repairing & Insuring Lease (FRI), the tenant is responsible for the building's interior and exterior maintenance / repair. The obligation is limited to the building's interior under an Internal Repairing & Insuring Lease (IRI). The preference will be to favour FRI terms (or FRI by way of service charge i.e. all costs relating to occupation and repairs are borne by the tenants and administered through a service charge).

- **Lot Size** – to maintain portfolio balance the preference will be for no single property investment to exceed £6m.

High scoring properties will typically be freeholds let long term to a single tenant with a strong financial covenant. Occasionally, opportunities will arise that do not score highly on the matrix criteria; for example, an empty property that falls within the Council's designated Plan E regeneration zone or one adjacent to an existing Council ownership. In these circumstances, the Matrix will not preclude low scoring properties being considered on their own individual regeneration / economic development merits, but the decision to purchase will be taken by either the Strategy & Resources Committee or full Council as appropriate.

Risk Management

Market forces

As with all investments, there are risks that capital values and rental values can fall as well as rise. To mitigate against future unfavourable market forces, acquisitions will be made on the basis that the Council is willing and capable of:-

1. Holding property investments for the long term i.e. 50 years +. This will ensure income and capital returns are considered over the long term thereby smoothing out any cyclical economic / property downturns.

2. Fixing borrowing liabilities. The Council can borrow from the Government's Public Works Loan Board at the lowest fixed interest rates for 20 years. Fixing borrowing rates at historically low levels will protect the Council from any future increases in financing rates.

Management

To mitigate the risk of void periods where the property is either partially / fully vacant or a tenant has defaulted on its rental obligations, the investment portfolio will be actively managed in accordance with the Council's adopted Asset Management Plan.

In addition, the investment criteria specified in the scoring matrix will tend to favour secure property investments i.e. high quality buildings in prime locations - thus mitigating the risk of void periods on re-letting.

Opportunities

The availability of suitable high quality investment property is generally limited and consequently, opportunities may be lost where vendors employ competitive bidding processes. Furthermore, the property investment market is often characterised by "off market" investment activity where, for a variety of reasons, opportunities are not freely marketed.

To mitigate the likelihood of lost opportunities, the Head of Property will actively build relationships with the investment agency community. The ability of the Council to make (and act upon) investment decisions at short notice is a key requirement for seeking out investment opportunities. It is proposed a dedicated Investment Property Group is established by the Council for this purpose.

Governance Arrangements

Investment Property Group (IPG)

A dedicated Investment Property Group will authorise the acquisition of property investments taking account of the overall investment and risk management criteria defined in this Strategy.

Subject to full Council approval, the IPG will receive delegated authority to make property investment decisions up to a defined budget / borrowing facility limit. Any subsequent amendments to the budget / borrowing limit will require full Council approval.

IPG membership will comprise:-

- Strategy & Resources Committee Chairman
- Strategy & Resources Committee Vice-Chairman
- Chief Executive
- Director of Finance & Resources
- Head of Financial Services
- Head of Property
- Head of Legal & Democratic Services

For a potential property investment to be considered by the IPG, it must:-

1) Achieve a minimum weighted score of 60 from the investment criteria matrix

   and

2) Be accompanied by a full business case.

The business case will be prepared by the Head of Property in consultation with finance and legal colleagues. Each potential property investment will undergo qualitative and quantitative appraisal to establish portfolio suitability and the legal / financial implications of the purchase. The Head of Property will seek external investment / technical expertise where specialist property market knowledge is required.

All acquisitions will be subject to building survey, purchase report and valuation. In view of the potential value of acquisitions, it is envisaged that the Council will be externally represented for each transaction by a property investment agent and legal firm. In almost all cases, the purchase report and valuation will be provided as part of the property investment agent's introductory fee.

Appendix A – Investment Criteria Scoring Matrix

Criteria	Weighted Score	Excellent	Good	Acceptable	Marginal	Poor
		5	4	3	2	1
Location	20	Major Prime	Micro Prime	Major Secondary	Micro Secondary	Tertiary
Tenant Covenant	20	Single tenant with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with strong financial covenants	Multiple tenants with good financial covenants	Tenants with poor financial covenant strength
Building Quality	15	Modern or recently refurbished with nominal capex required	Good quality with capex likely to be required within the next 20 years	Good quality with capex likely to be required within the next 10 years	Good quality with capex required within the next 5 years	Non-compliant with capex required within the next 5 years
Occupational Lease Length	20	Greater than 10 years	Between 6 and 10 years	Between 3 and 6 years	Between 2 and 4 years	Less than 2 years or vacant
Tenure	10	Freehold	Lease 125 years plus	Lease between 100 and 125 years	Lease between 50 and 100 years	Lease less than 50 years
Tenant Repair Obligations	10	FRI	FRI – partially recoverable	IRI – 100% recoverable	IRI – partially recoverable	Landlord responsibility
Lot Size	5	Between £4m and £6m	Between £2m & £4m or £6m & £8m	Between £1m & £2m or £8m & £10m	Between £500k & £1m or £10m & £15m	Less than £500k or greater than £15m
Maximum Weighted Score	**100**	**100**	**80**	**60**	**40**	**20**

REVISED PRUDENTIAL INDICATORS 2016/17 – FOR APPROVAL

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. (These are those previously reported to Council on 19th April 2016 and are hereby amended for the £20m borrowing requirement detailed in this report).

Capital Expenditure and Financing	**2015/16 Outturn £000's**	**2016/17 Estimate £000's**	**2017/18 Estimate £000's**	**2018/19 Estimate £000's**
Gross Expenditure	5,534	21,031	1,093	386

(Note - that if any of the 2016/17 £20m acquisition expenditure slips into 2017/18 or 2018/19 then this will be adjusted in the Capital Estimates and reported to Council Committees. Also note that the original capital estimate for 2016/17 still stands at £1.031m to which is added the additional £20m).

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	20,000	20,000	20,000

(Note - the CFR assumes that the £20m in 2016/17 is the total historic outstanding capital expenditure that has not been paid for and therefore rolls forward each year – it does not however mean a further £20m will be borrowed in 2017/18 and 2018/19. Also this amount each year will eventually reduce for the minimum revenue provision payment due).

The CFR is forecast to increase during 2016/17 and future financial years as any significant capital expenditure on property acquisition assets acquisitions will be financed by external borrowing / 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	20,000	20,000	20,000

Total debt is thus expected to increase in line with the CFR requirement in 2016/17 and maintain at that level in future years. Existing capital expenditure requirements have been funded from sources other than external borrowing.

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.

Operational Boundary	**2015/16 Revised £000's**	**2016/17 Estimate £000's**	**2017/18 Estimate £000's**	**2018/19 Estimate £000's**
Total Debt	0	20,000	20,000	20,000

(Note – it is estimated that the maximum "estimate" for external debt will be £20m, although clearly it could be less).

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 absolute 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	5,000	25,000	25,000	25,000

(Note that the Council's previous Authorised Limit was £5m to allow for cashflow movements and therefore this level of £5m will be retained and combined with the £20m of planned borrowing – this is considered a prudent measure).

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	(1.00)	(2.2)	(2.2)	(2.4)

The ratios above for Epsom and Ewell are 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 fixed at historically low levels. This is compounded as the Council's short term investment income is likely to increase if rates improve as they are not fixed for long periods. This is an indicator only and the investment income and cost of borrowing will have a separate budget.

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	21,031,000	1,093,000	386,000
Estimated Interest earned on short term investments	1.25%	1.50%	1.75%
Estimated Tax Base	32,013	32,013	32,013
Incremental Impact on Band D Council Tax	8.21	0.51	0.21

(Note that the Council Tax base is still being assessed for 2017/18 onwards and therefore the 2016/17 base is used for this indicator – important to note that this indicator is for illustrative purposes as a worse-case scenario and does not actually mean an increase to Council Tax at that level for Epsom and Ewell Borough Council).

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 13 April 2012.

ANNUAL MINIMUM REVENUE PROVISION POLICY STATEMENT 2016/17

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 previous to 2016/17. 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 a maximum of £20m at 31st March 2017 and in line with the CLG Guidance it will therefore charge MRP in 2016/17 on an asset life basis. This basis is subject to review and change in line with the Councils Treasury Management Strategy and approved Prudential Indicators which are revised annually.

Capital expenditure incurred during 2016/17 will be fully subject to a MRP charge from 2017/18 onwards.

IPD UK Annual Property Index

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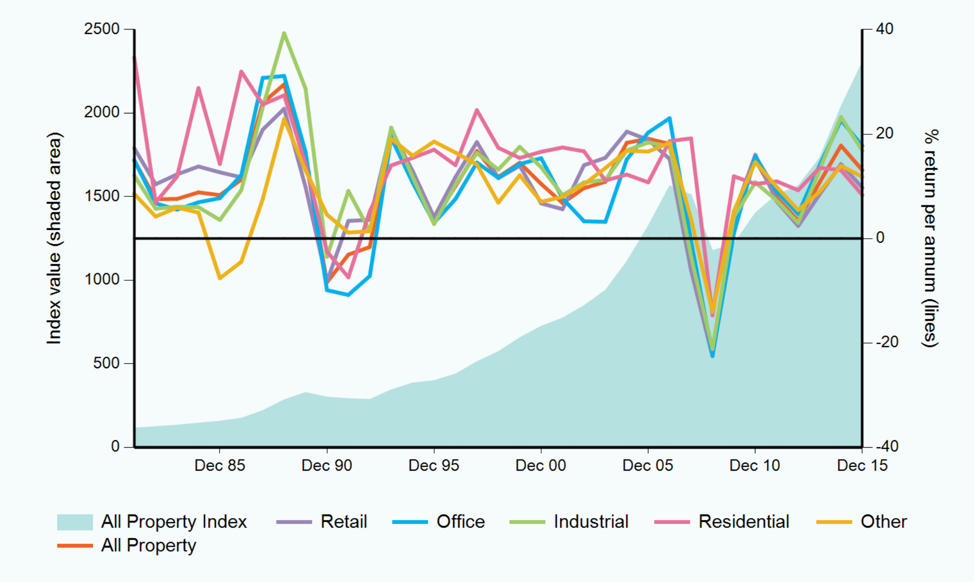
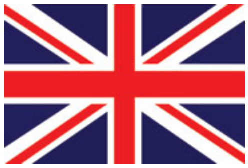
Results for the year to 31 December 2015





The IPD UK Annual Property Index measures ungeared total returns to directly held standing property investments from one open market valuation to the next and for 2015 returned **13.1%**

IPD UK Annual Property Index

	Total return index Dec 2014 Dec 1980 = 100	Total return index Dec 2015 Dec 1980 = 100	Total return % 1 yr	Income return % 1 yr	Capital growth % 1 yr	Annualised total returns % 3 yr	5 yr	10 yr
All Property	2,041.2	2,308.1	13.1	4.8	8.0	13.8	10.5	5.7
Retail	2,376.1	2,606.5	9.7	5.0	4.5	10.8	8.3	4.2
Office	1,731.4	2,038.3	17.7	4.1	13.1	18.1	13.4	7.6
Industrial	2,861.0	3,341.1	16.8	5.4	10.9	17.7	12.5	6.4
Residential	8,237.8	8,922.9	8.3	2.8	5.3	11.6	11.0	9.6
Other	1,668.0	1,864.8	11.8	5.5	6.0	11.5	10.0	7.4

Comparative data

Equities	3,820.2	3,737.8	-2.2	-	-	5.2	4.8	4.7
Property Equities	-	-	5.1	-	-	15.1	12.3	1.1
Bonds	-	-	1.0	-	-	2.3	5.4	5.6
Inflation	368.6	373.0	1.2	-	-	1.8	2.7	3.0

Data sources: MSCI, JP Morgan 7-10 yrs, RPI Inflation

IPD UK Annual Property database profile

	Capital value (£m)	Capital value (%)	Number of properties	Number of funds
All Property	201,986.2	100.0	23,639	275
Retail	85,503.6	42.3	4,072	218
Office	56,666.0	28.1	2,519	210
Industrial	33,979.4	16.8	2,895	201
Residential	8,724.3	4.3	11,579	74
Other	17,112.9	8.5	2,574	183

The figures above represent the full coverage of the IPD UK Annual Property database as at December 2015. The IPD UK Annual Property Index employs only fully revalued assets from that database.

Sponsors

AGENDA ITEM 2
ANNEXE 3

Disclaimer

Contacts

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EXCLUSION OF PRESS AND PUBLIC

Under Section 100(A)(4) of the Local Government Act 1972, the Committee may pass a resolution to exclude the public from the Meeting for Part Two of the Agenda on the grounds that the business involves the likely disclosure of exempt information as defined in Paragraph 3 of Part 1 to Schedule 12 A to the Act (as amended) and that pursuant to Paragraph 10 of Part 2 of the said Schedule 12A the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

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