Annex 11

Capital Strategy 2018/2019 to 2022/2023

Epping Forest District Council

INVESTOR IN PEOPLE

January 2019

Contents

Appendix

1. Introduction

1.1 The CIPFA Prudential Code was comprehensively updated in 2017 and it is now a requirement for all Councils to prepare and formally report on its investment strategy and associated risks through the provision of a Capital Strategy. The Code requires that councils should have in place a capital strategy to be implemented in 2019/20 that sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and the impact on outcomes. It will form a part of the integrated revenue, capital and balance sheet planning processes.

1.2 Epping Forest District Council's Capital Strategy is an important document which is fundamental to supporting the Council's commitment to improving the quality of its services and facilities to make the district a great place to live, work, study and do business. Capital investment in the form of large scale one-off projects plays a vital role in achieving this objective. It is essential that a strategic approach is taken, having regard to the Council's aims and priorities, and that the Capital Strategy is formulated in consultation with the community in order to direct resources into projects which will be of greatest benefit to the local community. Once approved, individual projects are carefully planned, managed and reviewed to ensure that best value is achieved. At the same time, every effort is made to maximise the generation of income in the form of capital receipts and utilise all capital resources available to fund capital investment in the most appropriate and advantageous way.

1.3 This Council's Capital Strategy has been prepared separately from other documents as it is a Corporate Policy but it maintains a strong and current link to the Council's priorities and to other key strategy documents including the Corporate Plan, Local Plan, Treasury Management Strategy, and the Council's General Fund Medium Term Financial Strategy and the Housing Revenue Account (HRA) 30-year plan.

1.4 As local authorities become increasingly complex and diverse it is important that those charged with governance understand the long term context in which investment decisions are made and the financial risks to which the Council is exposed.

2 Objectives

2.1 The main objectives of the Capital Strategy are:

- To demonstrate that the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability.
- To ensure that overall strategy, governance procedures and risk appetite are fully understood by all elected members
- To tailor this Council's investment strategy to meet local needs and circumstances.

2.2 The Capital Strategy is designed to provide a framework which aims to:

- To outline the basis for the prioritisation of capital schemes in relation to the achievement of the Council's strategic aims.
- To maximise external funding to augment the total resource available;

- To optimize the use of the Council's capital resources;
- To optimise the utilisation of the Council's assets in pursuit of its objectives
- To optimise returns on the Council's investment portfolio;
- To ensure that the investment required to maintain existing assets throughout their lives is made available;
- To establish a clear framework for managing and monitoring the capital programme;
- To evaluate projects to ensure they secure value for money, promote best procurement practice, and are subject to a rigorous risk assessment; and
- To facilitate joint and cross-cutting working.

3 Scope

3.1 The capital strategy is designed to focus on the following key areas :

- Capital expenditure
- Debt, borrowing and treasury management;
- Commercial activity
- Other long-term liabilities; and
- Knowledge and skills.

Capital Expenditure

3.2 This strategy focusses strongly on capital expenditure with regard to:

- an overview of the governance process for approval and monitoring of capital expenditure
- a long-term view of capital expenditure plans
- an overview of asset management planning
- any restrictions around borrowing or funding of ongoing capital finance.

Debt, borrowing and treasury management

3.3 The Council has both external borrowing with the Public Works Loan Board (PWLB) and 'internal' borrowing from cash balances. This borrowing is managed alongside the investment of cash balances (currently maintained at a minimum of £10,000 per annum) as part of the Council's Treasury Management Function.

3.4 The capital strategy links with the Treasury Strategy with regard to:

- the projection of external debt and use of internal borrowing to support capital expenditure
- provision for the repayment of debt over the life of the underlying asset
- the authorised limit and operational boundary for the following year
- the approach to treasury management including processes, due diligence and defining the risk appetite.

Commercial Activity

3.5 Epping Forest DC has a strong commercial asset base with a value of £114 million as at 31 March 2018, which was significantly expanded as a result of investing in the new shopping park at Langston Road, split as follows:

	31 March 2018 £'000
Shops (including shopping park)	73,500
Industrial and Commercial	21,919
Other	18,374
Total Assets	**113,793**

3.6 There has been an emerging commercialisation agenda in local government in the last few years as councils look to become more financially self-sufficient given reductions in central government funding since the financial crisis of 2008. This strategy covers this Council's approach to commercial activities, including processes, ensuring effective due diligence and defining the risk appetite, including proportionality in respect of overall resources.

Other long-term liabilities

3.7 As at 31 March 2018, Epping Forest had total long term liabilities of £262 million, the majority of which relates to the £185 million loan taken out with the PWLB when the HRA Self Financing system came into effect on 1st April 2012, under which councils were required to pay to the Government their notional HRA surplus, as determined by the self-financing settlement.

3.8 The Capital Strategy gives an overview of the governance process for approval and monitoring and ongoing risk management of any other financial guarantees and other long-term liabilities.

Knowledge and skills

This document gives a summary of the knowledge and skills available to the Council and confirmation that these are commensurate with the risk appetite.

4 Council Priorities and External Influences

4.1 The Local Plan is an important policy document which will guide development in the District in the coming years. It was submitted for examination in October 2018, and the Hearing sessions take place in the early part of 2019, with a potential adoption at the end of the year. It identifies a minimum of 11,400 additional homes and 10,000 additional jobs to be created over the Plan period between 2011 and 2033. Areas designated in the plan for future developments including strategic growth areas in Epping, North Weald Bassett and Waltham Abbey, as well as three Garden Communities which forms part of the Harlow and Gilston Garden Town around Harlow. The Council is working closely with relevant stakeholders to deliver this planned growth.

4.2 The new Corporate Plan runs from financial year 2018/19 to 2022/23 and was adopted by full Council on 21 December 2017. It is the Council's highest level strategic document, setting out the direction for the authority over the period of the plan. The stated vision is that Epping Forest is a great place where people enjoy living, working, learning and leisure and the Council's purpose is to work together to serve the community. It outlines the ambitions, aims and objectives which are designed to ensure that the vision becomes a reality. It links the key external drivers influencing Council services, as identified by Cabinet Members and the Council's Management Board and Leadership Team and refined through consultation, with a set of corporate aims and objectives, grouped under three corporate ambitions, which the Capital Strategy focusses on:

- Stronger Communities;
- Stronger Place; and
- Stronger Council.

Stronger Communities

4.3 The Council aims to provide customer excellence through its mission to work together to serve the community by putting the customer at the centre of its activities. It strives to support people to live longer, healthier and independent lives; help adults and children in times of need; and allow people and communities achieve their full potential. At present a review of sheltered housing schemes is being planned to assess the current level of appropriate housing provision for the elderly and to access if the existing accommodation is fit for purpose.

4.4 Effective Partnership working has always been a priority at Epping Forest and the Council works closely with external partners to make investment decisions and deliver capital projects which will build a stronger community and develop and maintain an economy that is strong and resilient, meeting local needs and aspirations.

4.5 The Council is committed to continuing to identify and secure opportunities for best value through either an external partner undertaking capital projects or jointly funding/undertaking projects in a partnership arrangement. The Council will also consult key partners on appropriate capital projects, in accordance with the Council's Consultation Strategy, to obtain views and feedback on proposals. For example, the Epping Forest District Safer Communities Partnership has been set up with the Police, Fire, Health, County Council and other agencies to give people who live and work in Epping Forest an opportunity to consult on future priorities.

4.6 Also, the Council has entered into a 153-year lease with local developer Higgins, to provide a mixed-use development on the site of the former Sir Winston Churchill Public House in Debden. The Council has provided the land for this development, made a financial input to facilitate the scheme and assisted in the occupation by tenants on the ground floor commercial units. The majority of the units are under offer or in negotiation and total income of £250,000 per year is anticipated when all units are let.

Stronger Place

4.7 The Council makes investments in order to create a stronger place to live and work. Public health, safety and well-being are key priorities and, by working with partners it proposes to improve the district's housing, support existing businesses and create an environment to attract new investments and opportunities for local people.

4.8 Housing has always been a top priority and the Council recognises the need to provide a high standard of affordable housing in a number of ways. It invests significant funds in maintaining and improving its own stock, currently adhering to the national Decent Homes Standard, and it has an ambitious programme of building new Council homes. The Council also works with the Epping Forest Strategic Housing Partnership to maximise the development of new affordable housing in the District. The partnership includes the Council's Preferred Partner Housing Associations who secure new affordable housing through Section 106 agreements and land-led developments. The Local Plan sets out a target of approximately 210 new affordable homes to be provided each year that are sustainable and built in the right places, protecting the natural character of the District.

4.9 With regard to the Council's own housebuilding programme, in December 2011, the Cabinet agreed its approach to the introduction and implementation of a new Council Housebuilding Programme, based on the construction of around 20 new homes each year for at least 6 years. The first phase of the programme delivered 23 properties over four sites in Waltham Abbey, the second phase is due to complete 51 new homes by June 2019 and phase three delivered 22 homes over 7 sites by the end of 2018 with a further 12 homes to be built at Queen's Road, North Weald by July 2020. In addition to this 6 properties were purchased off the open market, an additional 8 properties have been purchase as part of a section 106 arrangement with Lindon Homes and 6 homelessness pods are planned for delivery by the end of March 2019 to provide alternative housing from bed and breakfast accommodation for single vulnerable homeless people. Investment in the housebuilding programme will continue and planning permission has been approved for many sites within the next phases and feasibility works are currently underway.

4.10 Council investment has played a major role in enhancing the physical appearance of the District's towns in recent years and plans are in place to continue to provide additional facilities for local residents enhance visitor experience and ensure appropriate infrastructure provision is in place to support economic growth through targeted projects.

4.11 There has been a strong focus on enhancing the leisure facilities throughout the District in partnership with our leisure contractor, Places for People. Last year a modern new leisure centre was constructed in Waltham Abbey offering a range of high quality sports and physical activities, which has proved to be very popular with local residents. This new centre is part of a bigger development for which a project team involving representatives from the District Council, Essex County Council and NHS England was set up to develop designs for a new community hub, comprising of the new leisure centre, a health centre and an independent living scheme for the elderly at Hill House. To further enhance leisure facilities within the District, a new extension was added to the Loughton leisure significantly increasing the provision of fitness facilities and this has also proved to be a very successful investment.

4.12 It has been known for some time that Epping Sports Centre is close to the end of its life and that the centre at Ongar is not far behind. Members have been aware that we would need to re-provide the service on another site and to that end, when bids were submitted for the leisure management contract, an additional scenario was provided with the management fee to show the situation when and if this re-provision was to occur. Given that the original proposals for the St John's site have been abandoned, it is possible that the leisure re-provision can be made here and initial site investigates as to its suitability are already underway. The capital cost of a new leisure centre is likely to be in the order of £16 to £20 million. The intention is to produce a full development appraisal for the whole of the St John's Road Scheme, which will identify what capital contributions may be available to off-set the costs of any new leisure centre, by the sale of the existing site in Hemnall Street and the sale of any housing units identified in the adopted design and development brief. It will also consider the revenue implications, including potential revenue which may be generated by any retail/focal beverage units provided as part of the development. It is anticipated that by developing and expanding a range of other services and facilities available at this site, this will stimulate economic growth and encourage local investment. The appraisal will include the value of investment by other partners and reflect the risks involved.

4.13 An important partnership arrangement was put in place when Harlow and Gilston was designated as a Garden Town by the Ministry for Homes, Communities and Local Government in January 2017. Epping Forest, East Herts. and Harlow District Councils are working together with Hertfordshire and Essex County Councils to ensure plans for the Garden Town support sustainable living and a healthy economy; provide a good quality of life for existing and future residents; and respond to local landscape and character.

4.14 The Council is also looking to improve levels of digital connectivity and engagement to deliver services through a digital innovation programme and establish a digital innovation zone covering West Essex and Eastern Hertfordshire. Once achieved, the plan is to continue to explore the programme in order to build on the successful infrastructure network improvements and further develop the district's potential as a digital innovation zone.

4.15 To ensure that resources are targeted appropriately, the Council also uses condition surveys and asset management planning for both the Housing Revenue Account (covering the Council's 6,500 council houses) and the General Fund to inform priorities for capital expenditure.

Stronger Council

4.16 Epping Forest seeks to deliver customer satisfaction by providing an efficient and effective service, to nurture a culture of innovation and to achieve financial independence with a low council tax which is sustainable in the future.

4.17 The Council has an ambitious transformation programme which aims to continually improve services and adapt to a dynamic environment. A key part of this is to review the Council's accommodation needs and to make efficient use of the buildings and reduce operating costs. An in-principle decision has been made to relocate back office functions to a new building on Council owned land at North Weald. This will release land earmarked for residential development in the Local Plan including the Conder building, the rear extension and car park. The intention is to retain the existing front offices for customer service, civic and democratic functions whilst the remainder is let out to local businesses and various partners. Initial discussions have been started to this end. Based on information available at this early stage it is expected that the project can be funded from the capital receipt generated by the sale of the site supplemented by existing capital provision held as a result of a number of Civic Office projects put on hold by the review which totals a little under £1.2 million. Another part of the review involves relocating the housing repairs and housing asset teams to Oakwood Hill Depot, to reduce operating costs whist liberating the St John's Road site for development.

4.18 Capital investment has been committed to the Council's Technology Strategy programme (2018-2023) to ensure that technology is improved and updated in order to improve services to customers and to implement new ways of working. This includes flexible working, improving speed, accuracy and overall performance through innovation and new technology and removing barriers to working as one team.

5 Capital Expenditure

Approval of Capital Programme & Forecasts

5.1 The Council's Capital Programme for the five-year period 2018/19 to 2022/23 was reviewed and approved at Cabinet on 10 December 2018; this has been included at Appendix 1. It details the forecast capital investment in Council owned assets; estimates of capital loans to be made for private housing initiatives; and projected levels of revenue expenditure funded from capital under statute. Capital projects are supported by a business case and approved by Cabinet prior to inclusion in the capital programme. Work to develop benefits mapping for the new Corporate Plan 2018-2023 will, going forward, confirm the strategic relevance of projects and provide a transparent and objective approach to prioritising investments.

5.2 One of the key principles of the process for the approval of capital expenditure is to ensure that when the Council considers which capital projects to fund at the at Medium Term Financial Strategy (MTFS) or Budget Setting Report (BSR), those projects have been properly planned and developed and appropriate risks considered and are therefore ready to be implemented, subject to any procurement requirements. Plans for capital expenditure must also be linked to the Council's asset management plans.

5.3 New corporate project management processes established in 2016, along with the implementation in May 2017 of the performance and project IT system, Pentana, have significantly improved project management practices across the Council. Projects recorded on Pentana are subject to regular monitoring of progress against timescales and budgets, and risk management and change control processes are in place. Additionally, projects are evaluated on closure to review the benefits expected and to identify learning points to take forward to other projects. The process of loading all capital schemes on Pentana is ongoing.

5.4 Capital project finances are reported as part of the quarterly financial monitoring to the Finance and Performance Management Cabinet Committee. Regular highlight reporting from Pentana provides an update on the progress of projects to both senior management and Members, To avoid the exclusion of any projects. all capital projects should be registered with the Transformation Programme Management Office (TPMO) to benefit from the support provided by the TPMO and to ensure there is full and proper monitoring and reporting of projects from Pentana in line with Council procedures.

5.5 Many capital schemes are considered as part of other strategies and programmes such as the Council's housebuilding programme, Accommodation Review, Technology Strategy programme and planned maintenance programme. A number of member and officer forums exist to assess the costs and benefits of each scheme including the Council Housebuilding Cabinet Committee, Asset Management and Economic Development Cabinet Committee, Service Accommodation Programme Board, St John's Road Redevelopment Project Team North Weald Airfield Masterplan Team and the Asset Management Co-ordination Group meeting.

5.6 Project appraisals are undertaken for all capital schemes in excess of £2,000,000 (and appropriate schemes of lesser amounts) in order to:

- Assess how the project will meet the Council's aims
- Provide estimates of expenditure
- Examine appropriate options

- Set out any relevant consultation arrangements
- Identify the most appropriate method of procurement
- Explain the proposed method of project monitoring and review
- Provide an assessment of key risks and their management.

5.7 In considering individual capital items and the programme overall, the Council ensures that they are line with its vision and strategic objectives and due consideration is given to the environmental issues such as sustainability, energy and waste management endeavoring at all times to reduce potential effects upon the environment. In the light of this, the Council has adopted the "Nottingham Declaration" and is thereby committed to managing its internal processes in a way that mitigate and adapt to the potential effects of climate change.

5.8 When appraising potential capital schemes, it is essential that the associated revenue implications are assessed, since these can be an important factor in deciding whether a scheme should be undertaken and, indeed, its relative priority compared with other projects. The project appraisals therefore require the associated revenue implications to be identified. Once identified and approved, the revenue implications are incorporated within the Council's revenue budget and monitored accordingly.

5.9 To expedite the success of each capital scheme, performance is monitored and reported on a quarterly basis to the Council's Management Board, Finance and Performance Management Board, Scrutiny Committees and Cabinet. The purpose of the scrutiny committees is to help ensure that the work is delivered effectively, efficiently and in the best interest of the community.

<u>Capital Financing</u>

5.10 With regard to financing the Capital Programme, proposed sources of finance are set out and approved for a five-year period as part of the Capital Review each year. The funding is based on maximising the capital resources available to finance each scheme and using direct revenue funding where appropriate.

5.11 The Council maintains a consistent policy of prudence in forecasting available capital resources to ensure that any capital project included in the Capital Programme will be fundable. It is usual to include only those capital receipts received when the Review is undertaken, agreed loan repayments, plus the projected receipts from the sale of council houses. No recognition of other potential receipts is usually made and, when predicting levels of available capital funding, receipts from future land sales are not usually taken into account. However, where appropriate, certain agreed sales are included in the anticipated funds available. Currently, the receipt in respect of the sale of the Pyrles Lane nursery has been taken into account.

5.12 A prudent view is also taken for other sources of capital funding including funds receivable from Government grants and private contributions. The availability of Section 106 monies to fund capital projects is based on payments received to date and not payments anticipated in the future and are allocated by the appropriate committee. Those received for the provision of affordable housing are currently used to support the Council's own house-building programme.

5.13 With regard to funding the new housebuilding programme, maximum use is made of the retained 1-4-1 Right To Buy (RTB) capital receipts available for replacement homes under the pooling regime in addition to 30% of the Assumed Debt element of the un-pooled RTB receipts. This situation is monitored through the quarterly HRA Financial Plan Review. The remaining un-pooled RTB receipts, up to the Government cap, are utilised to finance General Fund schemes in order to keep borrowing to a minimum.

5.14 Based on the approved Capital Programme, borrowing is expected to be in the order of £8,227,000 to finance some General Fund projects over the next five years; where the term borrowing refers to either internal or external borrowing. Work is being undertaken to assess when external borrowing will be required, but forecasts currently suggest that it will be in the 2019/20 financial year and that it will fall within the authorised limit approved by Members. With regard to the HRA Capital Programme, it is thought that no increase in external borrowing will be necessary in the next five years.

5.15 Where the Council identifies that capital expenditure is to be borrowed, either externally or internally from cash it ensures that a prudent Minimum Revenue Provision (MRP) charge is made to revenue to fund the expenditure. This ensures that the Council is making appropriate provision to fund the repayment of external debt or 'repay' cash balances internally borrowed. There may be circumstances in which MRP is not judged to be required. If this is the case the reasons are specifically outlined in the MRP Policy. The MRP policy is published each year as part of the Treasury Management Strategy.

5.12 Revenue contributions to capital represent a significant source of funding for the Housing Revenue Account. The Council is required to make a contribution from revenue resources to the Major Repairs Reserve each year, this being equal to the assessed depreciation on HRA assets. This funding is predominantly used on capital works carried out on the existing stock to ensure it meets the decent homes standard. The HRA also uses direct revenue funding from its revenue resources to support the housebuilding programme. The use of direct revenue contributions for General Fund schemes is generally relatively low and in recent years it has been used primarily for Invest to Save schemes.

<u>Asset Management Planning</u>

5.12 The Council regularly reviews the condition of its existing assets, using specialist advisors where appropriate. This includes reviews of the maintenance requirements of operational property, council housing stock and investment properties. The maintenance costs of existing assets are considered carefully alongside replacement or upgrade decisions where annual revenue budgets include provision for the maintenance of assets while capital bids are put in place for replacements and upgrades.

5.13 With the exception of the £185 million loans taken out on the inception of self-financing of the Housing Revenue Account at the end of the previous subsidy system, the Council currently has no external debt. It therefore does not need to consider the impact of past borrowing on asset management plans.

<u>Disposals</u>

5.14 Disposal of assets is subject to scrutiny by the Asset Management Co-ordination Group, Asset Management and Economic Development Cabinet Committee and Cabinet. Detailed cases are prepared for any asset disposals and appropriate independent advice taken to ensure that best value is achieved on disposals, taking into account any strategic objectives. The Council is also obliged to sell Council properties under the Right to Buy legislation to qualifying tenants.

5.15 The Council's current plans for disposal include the sale of the Pyrles Lane nursery site, Loughton. On the 18 October 2018 a private report was considered by Cabinet where the sale of Pyrles Lane Nursery to Durkan Developments was agreed in excess of £3 million, on the basis of a development of 36 homes to which 40% of the homes would comprise of affordable housing, in the ratio of 75% affordable rented and 25% shared ownership. Durkan Developments are in the process of conducting their legal and site due diligence and the Council has appointed solicitors to progress the sale.

Another site being considered for disposal is that of the former swimming pool at Roundhills, Waltham Abbey. Cabinet agreed on the 18 October 2018, that Essex Housing, be appointed as the development consultants for the preparation and submission of an outline planning application and the demolition of the swimming pool,

As referred to in paragraph 4.17 an appraisal is in hand for the disposal of land to the rear of the Civic site in line with the Local Plan allocation, with a view to the sale being agreed before end of the financial year 2019/20.

Funding and borrowing restrictions

5.16 Under the Prudential Code the Council has discretion to undertake borrowing which is prudent, affordable and sustainable from, for example, the Public Works Loan Board. However, there are a number of restrictions around the borrowing and funding of capital expenditure and these are taken into account in the development and monitoring of the capital plan.

5.17 In respect of the Housing Revenue Account, there was a 'cap' on the debt limit allowable and housing authorities were invited to make bids to Homes England for additional HRA borrowing. Although Epping Forest did submit a number of bids, the Government removed the debt cap in October 2018 making HRA indebtedness subject to the normal provision that that any borrowing is affordable by the HRA.

5.18 The majority of the receipts from asset disposal come from the sale of council homes under the Right to Buy. The Council remains subject to the agreement with The Ministry of Homes and Local Government (MHCLG) that allows the retention of right to buy receipts, subject to a set of specific conditions. The gross receipts are separated into different categories for their treatment.

5.19 The first call on the receipts is the allowable (or attributable) debt which the authority keeps, derived from the level ascertained from the self-financing settlement for the expected number of sales. The receipts can either be distributed to the HRA or the General Fund. The Council's Cabinet has agreed that an equivalent value to 30% of 'assumed debt' within the self-financing settlement can be used for funding new build within the HRA with the balance going to the General Fund.

5.20 Before self-financing, local authorities were able to retain 25% of net Right to Buy receipts, with the remaining balance returned to Government. This is still accounted for within the treatment of the receipts but based on a pre-determined value by the Government. For Epping Forest, this 25% factor is equal to £340,000 and is used for General Fund purposes. If the actual number of Right to Buy sales in future years falls below the pre-determined level within the self-financing settlement then this level of receipt is at risk to the Council's General Fund.

5.21 The next call on the receipt is the amount that the Council can retain to help fund Right to Buy 'buy-backs' that were originally purchased within 10 years of the RTB sale. The formula allows, with quarterly restrictions, 50% of the amount that was spent by authorities on these 'buy-backs'.

5.22 Finally, if a balance remains within the quarter, this is transferred to a ring-fenced '1-4-1' reserve. Currently, 1-4-1 receipts must still be spent within a 3-year timeframe, to fund the delivery of new social housing, with a maximum of 30% of the dwelling being met via this funding stream and the balance of 70% funded from the Council's own resources or borrowing. Failure in delivery results in the receipt having to be paid to central government, with interest at 4% above the base rate, which far outweighs the interest earned on the receipt whilst held by the authority. Plans have been put in place spend all 1-4-1 receipts on the Council's housebuilding programme, but slippage has occurred and in 2016/17 it was necessary to repay £1.36 million. The situation is regularly and carefully monitored to identify any receipts which will not being used within the prescribed timescales and these will be paid to Government immediately to avoid interest penalties.

MHCLG has recently consulted on allowing extending the spend period from 3 years to 5 years for current receipts received to date and the possibility of increasing the 30% allocation to 50% of build costs for properties let at social rents where a case for a clear need for lower rents is demonstrated. The outcome of the consultation is awaited.

5.23 The Government had planned to introduce a levy on HRAs in respect of high value properties. This would have necessitated the disposal of HRA properties. A Housing Green Paper issued in summer 2018 indicated the Government's intention not to go ahead with this but the Council awaits the repeal of primary legislation in this area.

5.24 The Council must also ensure that it observes the ring-fence between General Fund and Housing Revenue Account resources.

<u>Capital Receipt Flexibilities</u>

5.25 Under a direction issued by central government in February 2018 authorities can choose to use capital receipts received in the 6 years commencing from 1 April 2016 to fund the revenue costs of transformation projects. Qualifying expenditure must 'generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that will reduce costs or demand for services in future years for any of the public sector delivery partners.' The Council does not currently plan to take advantage of this flexibility given the low levels of General Fund capital receipts it holds. This position can be kept under review. Any decision to take advantage of the flexibility would require the development of a strategy to be approved by full Council.

5.26 The use of capital receipts to fund the capital programme is reviewed and approved by Cabinet annually as part of the Capital Review, taking into account the allocation between the General Fund and HRA where no restrictions apply.

6 Debt, Borrowing and Treasury Management

Summary

6.1 Appendix 2 shows a summary of the Council's Capital Financing Requirement (CFR), which represents its total underlying need to borrow, together with the level of external debt and internal borrowing from cash balances as at 31 March 2018.

6.3 The Prudential Code requires that the Council set and publish an authorised limit and operational boundary for external debt. These can be found in the annual Treasury Management Strategy.

External Debt

6.4 As a consequence of the self-financing settlement in March 2012 the following loan facilities with the Public Works Loans Board (PWLB) were taken out by the Council to finance the transaction:

Loan £m	Interest Basis	Interest Rate	Maturity
31.800	Variable	0.62%	Mar 2022
30.000	Fixed	3.46%	Mar 2038
30.000	Fixed	3.47%	Mar 2039
30.000	Fixed	3.48%	Mar 2040
30.000	Fixed	3.49%	Mar 2041
33.656	Fixed	3.50%	Mar 2042

6.5 Given that the vast majority of the loan value is fixed the Council is certain of most of the interest that will be charged to the HRA. The variable loan is subject to changes in PWLB rates, therefore interest forecasts need to be continually reviewed to mitigate the impact of potential increase in the interest base rate.

6.6 The Council's HRA CFR (accounting debt level) was in fact in a negative position of £31 million prior to self-financing, due to the capital receipts from right to buy receipts. This means the actual HRACFR is currently £154 million against the loan total of £185 million, which results in the HRA being 'over-borrowed'. This arrangement was required to ensure that the General Fund was not adversely affected by the self-financing settlement at the time, which is a need that continues.

6.7 Although the Council is not required to make MRP payments on this debt, the HRA has a 30 year business plan which demonstrates its ability to meet the costs of this debt and the options for repayment or refinancing.

Treasury Management

6.8 The Council manages its deposits in-house and The Council recognises that responsibility for treasury management activities activity is delegated to officers in the Council's Finance team in line with the defined Treasury Management Practices. The Council uses Arlingclose as its independent Treasury Adviser and ensures that the terms of Arlingclose's appointment are properly agreed and documented and regularly reviewed.

6.9 The Council's deposit priorities are as follows:

- The Security of capital;
- The Liquidity of deposits; and;
- The Yield or return on its deposits.

6.10 The Council takes a cautious approach to its Treasury Management Strategy. In order to ensure that the Council invests its funds in the most appropriate way, the Strategy is regularly reviewed taking into account the information available from Arlingclose and wider developments.

6.11 The Council uses the creditworthiness service provided by Arlingclose which is updated daily for the authority to use. This service uses a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies: Fitch, Moody's and Standard & Poor's. However, the Council does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:-

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings i.e. akin to an insurance policy whereby counterparties enter into a contractual agreement; and;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.12 The Council will not place an investment contrary to Arlingclose's credit methodology criteria which includes a maximum duration period (except for 'smaller' Building Societies). In addition to considering the creditworthiness of counterparties the Council also considers the duration of deposits to ensure the appropriate liquidity of funds.

6.13 The current investment position is reported as part of the Council's budget monitoring reporting to Finance and Performance Management and Resources Select Committees. Investment performance is formally reported to Finance and Performance Management Committee, Audit and Governance Committee and Full Council at the mid-year and outturn.

7 Commercial Activity

7.1 Where the Council invests in non-financial assets, it considers security, liquidity and yield, as it does for financial assets.

7.2 Specifically in relation to non-financial assets:

- Security – the Council recognises that it will normally have an asset that can be used to recoup capital invested. Therefore, it ensures through annual valuations at fair value, that there is sufficient value in assets and the portfolio as a whole to protect the funds invested.
- Liquidity – the Council also has a number of operational and surplus assets and is therefore able to look at potential disposals to access funds. The portfolio is well-diversified and the Council is not unduly exposed to needing to rely on the disposal of a key asset for liquidity. It should also be noted that the Council maintains significant financial investments to meet its liquidity needs.

Investment in new properties

7.3 The Council has historically owned a significant investment property portfolio, including retail, office and industrial properties. The Council's existing portfolio has a mix of industrial and retail properties which are held under different arrangements from directly managed occupational leases to long leasehold geared ground leases.

7.4 Given the historically low returns on financial assets, Epping Forest, in line with other councils, has made additional investments in commercial properties in recent years. The largest was an investment of £31 million on the construction the Shopping Park at Langston Road, Loughton, which was completed in June 2017. All twelve units are now operational with the final unit being opened to the public on the 31st October 2018.

7.5 The primary aim of doing this is to generate income through long term retention rather than regular property trading to release capital as this is considered to best meet the Council's aims and objectives.

7.6 Where new investments are considered the Council appoints agents to advise on suitable commercial property investments. Key issues include how an investment fits with the Council's existing portfolio, location, rate of return, risk, management arrangements, condition, accessibility and environmental performance of the building. Exceptions could occur if the investment was a strategic fit with existing property such as an adjoining property or the acquisition of a long leasehold interest where the Council is also the freehold owner.

Monitoring the performance of the overall portfolio

7.7 The Council's sizeable property portfolio includes equity stakes in a major shopping centre, many of small business units some of which are aimed at small local and start-up companies plus over 120 shops in council estate locations which provide important local services for their communities. The total value of investment properties at 31 March 2018 was £114 million. The Council considers that the investment property portfolio retains sufficient value (measured using the fair value model) to provide security of investment.

7.8 Performance of the portfolio in rental terms is monitored by officers and members via the budgetary control process. Based on audited financial statements the yield achieved is as follows:

	31 March			
	2018	**2018**	**2018**	**2017**
	Expenditure	**Income**	**(Surplus) / Deficit**	***(Surplus) / Deficit***
	£000	**£000**	**£000**	***£000***
Commercial Properties	625	(2,247)	**(1,622)**	*(1,633)*
Industrial Estates	202	(1,692)	**(1,490)**	*(1,350)*
North Weald Centre	1,143	(937)	**206**	*539*
Shopping Park	189	(1,471)	**(1,282)**	-
Total (Surplus) / Deficit	**2,159**	**(6,347)**	**(4,188)**	***(2,444)***

7.9 The Council's investment in property exposes it to a number of risks including:

- A reduction in the capital value of the asset or rental incomes due to economic conditions
- Void periods where properties cannot be let

7.10 A key element of the work of Estates and Valuation Team is monitoring the performance of assets to identify any that are currently held which are deemed to be under-achieving, or which are no longer appropriate to hold in the portfolio. This enables consideration to be given to alternate uses or disposal.

Proportionality of investment property holdings

7.11 Following significant activity in the commercial property market by local authorities, including district councils, concern has been expressed by MHCLG and CIPFA about the size of some property holdings. Particular concern has been raised about those councils which are externally borrowing to invest in property. To date, Epping Forest has not used external borrowing to fund investments, but has instead used reserves or internal borrowing.

7.12 Although Investment Guidance and the Prudential Code were updated in early 2018 there is a suggestion that further guidance or regulation may be issued to local authorities. This is likely to focus on the concept of 'proportionality' when considering the size and scale of new property investments and could involve the introduction of prescribed ratios.

7.13 However, whatever the statutory guidance, to which regard must be had, may be from time to time, and whatever the issues of interpretation to which the guidance may give rise, investment on a large scale in commercial property is an activity which requires the Council to ensure appropriate due diligence and prudence.

7.14 The audited financial statements at 31 March 2018 show that the Net Cost of Services (net of service related income) chargeable to the General Fund was £28.3 million. Net Income from Investment Properties was 14.8% of this figure. This is consistent with the proportion for 2016/17. The Council does not identify specific funding sources for services, so the income from properties contributed to the overall funding resources available to the Council including council tax and income from government grants and business rates. The use of investment property income to support the Council's activities has been established over many years.

8 Other Long-Term Liabilities

8.1 The Council may take on liabilities in the course of the provision of operational services. Examples may include financial guarantees, including those given in respect of subsidiaries or joint ventures. Where decisions are made for service purposes, these may be outside of normal commercial terms, including liquidity, security and/or yield. Where such liabilities are taken on the Council ensures that financial risks are clearly identified and quantified along with any implied subsidy as part of the decision-making process.

8.2 In 2015 the Council advanced a loan of £4.1 million in two tranches to Biffa for the purchase of the waste vehicles from the Council. All repayments are due to be completed by January 2020. This arrangement is not thought to represent a risk to the Council.

8.3 Since 1 July 2012, the Council has advanced a number of interest free loans in respect of improvements to private sector properties. Although there is a small cost to the authority in terms of lost interest, the loans are secured on the properties and are therefore considered to be of low financial risk to the Council. Each loan is less than £20,000.

8.4 In previous years the Open Market Shared Ownership Scheme provided interest-free loans to B3Living to enable first time buyers to purchase properties on the open market. The scheme was completed over two phases and was very successful in helping several people in the District to enter home ownership. As the Council maintains a share in the properties which, to date, has risen in value, they are not considered to represent a risk to the Council.

9 Knowledge and Skills

Treasury Management

9.1 Treasury Management Activity is undertaken by a Senior Accountant and Principal Accountant in the Accountancy Team. They are managed by a CCAB qualified accountant. The team has many years of treasury management experience and has recently demonstrated that it has the skills to opt-up to Professional status under the MiFID II reforms.

9.2 The CIPFA Code requires the responsible officer to ensure that Members and Officers are adequately trained in treasury management. Training is arranged as required and is regularly reviewed.

Property Assets

9.3 The Council's investment property is managed by the Estates & Valuation Team, an experienced team of 5 staff. The team includes 4 chartered surveyors with over 80 years of property experience in both the private and public sector. This extensive experience includes dealing with a mix of property types and professional work including professional services, landlord and tenant, statutory valuations, acquisitions and disposals, commercial and residential property management.

9.4 The Estates & Valuation Team also works with external agents where specialist expertise is required to deal with particular properties or resource is not available to deal with matters in a timely way. Examples of where external advice is used include agency, valuation, building surveying and planning work. The Council also has internal building surveying resource in the Facilities Management Team to advise on construction, repair and maintenance, and statutory compliance matters across its investment properties. The Facilities Management Team commission and manage repairs and maintenance as well as capital investment programmes either directly or through framework contracts.

9.5 The Council's asset valuations for its financial statement are prepared by external agents with an agreed rolling programme of valuations for the whole Council property portfolio. All material investment properties are valued on an annual basis.

9.6 When investing in new investment property, the Council has appointed external agents to advise on and negotiate the terms of acquisition, recognising that others are closer to the investment market on a day to day basis than the Council's in-house team in some cases. As well as advising prior to acquisition, the agents undertake due diligence which helps to ensure that those charged with governance can make informed decisions.

External advice

9.7 In addition to the use of external agents in the purchase of investment properties the Council makes use of other external advice as necessary for capital and treasury activity. This includes getting appropriate legal and other professional advice on more complex projects and capital transactions and the appointment of Treasury Management advisors.

10 Section 151 Officer Summary

10.1 The Council's Section 151 Officer is required to report explicitly on the affordability and risk associated with the Capital Strategy

10.2 As highlighted in this report the Council ensures that capital projects and schemes are accompanied by detailed funding proposals. Where projects are to be funded from borrowing, either internally from cash balances or externally, a prudent Minimum Revenue Provision charge is made. The Council has not borrowed externally to fund capital expenditure in the recent past, the current external borrowing representing debt incurred on the transition from the old housing subsidy system to HRA self-financing.

10.3 Where the Council has expanded its commercial activities it ensures that the risks taken are proportionate to the size and scale of the authority. Legal advice is taken alongside the completion of appropriate due diligence and any loans are secured where appropriate. The Council has not borrowed externally to fund the increase in commercial activity and if future external fund funding becomes necessary appropriate external advice will be sought as necessary