Report to	Council 28 November 2017	**Item**
Report of	Chief finance officer	10
Subject	Adjustment to the 2017/18 non-housing capital programme	

Purpose

To consider an increase to the non-housing capital programme.

Recommendations

To approve cabinet's recommendations of 8 November 2017 to

(1) increase the asset investment for income budget by £15m, and as a result of recent asset acquisition opportunities, to further increase this budget at the recommendation of officers and with the approval of the leader and portfolio holder by £10m, giving a total increase of £25m; and

(2) Increase the New Build - Three Score Phase 2 budget by £1.6m.

Corporate and service priorities

The report helps to meet the corporate priority value for money services.

Financial implications

These are set out in the main body of the report.

Ward/s: All wards

Cabinet member: Councillor Kendrick – resources

Contact officers

Karen Watling, chief finance officer (LGSS)	01603 212440
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Background documents

None

Report

Background

1. At its meeting on 27 September 2016, council approved a four year financial sustainability plan. This was submitted and subsequently agreed by DCLG (Department for Communities and Local Government) which allowed the council to receive the current four–year Financial Settlement from government.

2. The sustainability plan linked the council's Transformation Plan to its MTFS (Medium Term Financial Strategy). The top two themes of the plan were:

   - Maximising income generation where possible whist taking into account the ability to pay.

   - Maximising returns from assets, particularly the council's commercial portfolio and investing for further return.

3. The capital programme for 2017/18 was approved by council on 23 February 2017.

4. The carry-forward of unspent 2016/17 capital budgets into the 2017/18 capital programme was approved by cabinet on 21 June 2017. These are included in the budgets shown below.

5. Cabinet at its meeting on 8 November 2017 resolved to recommend to council a £15m addition to the non-housing capital programme, officers with the approval of the leader and portfolio holder are now recommending an increase to £25m.

6. Council is asked to approve the addition of the following amounts to the current approved 2017/18 non-housing capital programme: both capital schemes are part of the Council's strategy to generate income and maximise returns from assets as agreed in the four year financial sustainability plan.

Scheme	Current approved budget £000s	Requested increase to programme £000s	Revised budget £000s
Asset Investment for Income	15,000	25,000	40,000
New Build - Three Score Phase 2	11,122	1,647	12,769

Asset Investment for Income Generation

7. Holding and acquiring commercial property is not new for councils in general and Norwich in particular. The Council already owns 290 properties held for income purposes generating an annual rental income of some £2m. 41 of these properties (capital value of £17m) generate 74% of the overall rental income. The "top 41" assets primarily comprise retail/restaurant, offices, and warehouse/industrial/storage.

8. This rental income is of increasing importance in helping the Council to fund General Fund services to the public particularly given that central government financial support is rapidly decreasing.

9. In line with the approved four year financial sustainability plan, Cabinet agreed on 12 April 2017 to rationalise the council's existing investment portfolio to minimise cost and maximise income. The rationalisation means that existing property with low returns, or those requiring significant funding to refurbish or to maintain/manage will be sold. To compensate for this loss, and to also provide additional income growth, Cabinet agreed to acquire new income generating assets

10. The council recently bought its first acquisition under this rationalisation programme for the sum of £2.4m. It has successfully bid for two more, one at £7.2m and one at £4m (these are the total costs of acquiring the property including fees and Stamp Duty Land Tax). It is anticipated that these will complete before or soon after Christmas. As of writing this report, we are also reviewing further properties with a value of £19m plus. It has become apparent that the 2017/18 capital budget is unlikely to be sufficient to purchase all the opportunities the council may wish to pursue this financial year

11. Council is reminded that delegated authority was given to the director of regeneration and development, in consultation with the chief finance officer and the equivalent number of a quorum of cabinet members, including the cabinet member for resources, to invest in income generating assets up to the limit in value budgeted for in the council's capital programme. This approach ensures that the decisions can be made to meet commercial timescales (where the gap between initial marketing and bid submission may be as little as two weeks) but also enable democratic oversight.

12. The capital programme agreed by Council in February 2017 is for £15m of acquisitions in this financial year and £10m per annum for the next 4 financial years. It is recommended that council brings forward to this financial year some of the future years' capital budget to give more flexibility in purchasing suitable property investments. The splitting of the total budget the council wishes to spend on property acquisition into financial years is not particularly helpful in aiding the council pursue potential opportunities as they present themselves in the market place.

13. The council is in a competitive market and has already been unsuccessful in two of its bids. The capital budget therefore may not be totally spent by the year end, but unless the budget is increased then the sum approved by Council for this financial year seems likely, at this point in time, to stop further acquisitions until next financial year, which may mean the council does not receive potential new rental income that it could otherwise have gained.

14. Each potential property opportunity is reviewed by the council's retained property consultants, Carter Jonas. The costs and income flows are modelled financially by LGSS Finance to give a worst case and best case scenario:

    i) Worst case is where the council has to fund the acquisition by loan and has to offset the gross rental income from the property with interest rate and MRP (Minimum Revenue Provision) charges.

    ii) Best case is where the council self-funds the acquisition using its available cash and thereby charges the loss of interest income and MRP against the gross rental income.

    iii) MRP is an annual cost to the revenue budget over the economic life of the asset which provides a sum of money over time to repay the loan principal (if the property is funded by external loan) or to replace the amount of cash "borrowed" internally.

15. The potential property acquisition is physically visited by Carter Jonas who scores the property against a matrix of agreed criteria including macro and micro location, financial strength of the existing tenant, the nature of the lease, likelihood of future rental increases, and the physical condition of the property. NPS also give a professional view of the property.

16. Carter Jonas advises on the value of the property and hence the bid the council submits. Once a bid is made and accepted by the vendor, various condition surveys are undertaken and NPLaw undertakes the due diligence required to enable exchange of contracts and thence completion.

17. The commercial properties recently acquired or likely to be acquired by the Council are giving us a full year rate of return between 3.8% and 4.3% - this is net of costs. These purchases were/are to be financed by using available cash (in the bank or in other investment deposits) which earns an average rate of interest of 0.6%. The CFO has undertaken an analysis of the property the council has reviewed and bid for to-date and has assumed a 2% net return in the MTFS for new net rental income arising from the acquisition of commercial property. The target return takes into account that the council cannot fund all property acquisitions in the future by using its cash but will need to borrow at some point to do so. The extra £25m would therefore be expected to generate at least £500k extra income.

18. A formal proposal will be included in the Budget Report to be considered by Cabinet and Council in February 2018 to use the extra net income generated to both: (a) support the General Fund revenue budget and the provision of services to our citizens; and (b) to set aside a significant element of the new income generated to provide for future repairing and upgrading of the Council's commercial property portfolio so as to maintain its capital value and to help safeguard rental income returns in the future.

New build housing – Three Score Phase 2

19. This capital budget is used to fund the council's lending to Norwich Regeneration Ltd (NRL). The company then uses the loan to finance the house building at the Threescore site.

20. Now that construction has physically started on site, and a new, more robust, financial model for the company has been created, firmer projections can be given for the timing of the Phase 2 construction and the impact on the company's financial position. The company will need to borrow £1.65m more this year from the council than originally anticipated, not due to any increase in construction costs, but to re-phasing of the construction programme.

21. The council receives new income into its General Fund revenue budget by on-lending to the company at a commercial rate which is above the rate it can itself borrow from the Public Works Loans Board (PWLB). There is a net benefit to the Council of around £25,000 for each £1m borrowed by the company.

Integrated impact assessment

NORWICH City Council

Report author to complete	
Committee:	Council
Committee date:	28 November 2017
Director / Head of service	Chief finance officer
Report subject:	Adjustment to the 2017/18 non-housing capital programme
Date assessed:	8 November 2017
Description:	Increase the non-housing capital programme budget by £16.647m

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)		X		
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	X			
Economic development	X			
Financial inclusion	X			
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	X			
S17 crime and disorder act 1998	X			
Human Rights Act 1998	X			
Health and well being	X			

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	X			
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	X			
Natural and built environment	X			
Waste minimisation & resource use	☒	☐	☐	
Pollution	X			
Sustainable procurement	X			
Energy and climate change	X			
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	X			

Recommendations from impact assessment
Positive
None
Negative
None
Neutral
None
Issues
None