CABINET

19 April 2022

Title: Investment and Acquisition Strategy Update	
Report of the Cabinet Member for Finance, Performance & Core Services	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
Report Author: David Dickinson, Investment Fund Manager	**Contact Details:** E-mail: david.dickinson@lbbd.gov.uk
Accountable Strategic Leadership Director: Philip Gregory, Director of Finance and Investments	

Summary:

In October 2020 Cabinet approved an updated Investment and Acquisition Strategy (IAS) to support the Borough's growth opportunities and to ensure that the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets. The IAS is reviewed annually, with this being the fifth version. The delay in producing this report is to allow the report to follow on from the Be First and Reside Business Plans and in future it will be reported each April.

An objective of the investment strategy is to generate net income of £6.92m. This report provides an update on the performance of the IAS in 2021/22 (provisional), outlining the changes that have impacted the strategy over the past year. The report also provides the outturn for 2020/21, provides a forecast of the returns expected over the coming four years and the current position of the IAS reserve.

This report highlights the financial constraints and opportunities within the IAS. 2021/22 has been a very difficult year for the residential part of the strategy, both on the operational side and the development side. The impact of these pressures and how they have been mitigated against is extensively covered in this report. The industrial parts of the strategy have performed well, both from income generation but also from on-selling and the positive impact of this is also outlined in the report.

The report stresses the importance of bringing schemes into operation as soon as possible to ensure both the regeneration of the borough, and the availability of funding available for subsequent schemes. An additional consideration is on the impact of leverage on the strategy and the need to bring a more long-term and measured approach to development.

The report is at a point in time and there are schemes in the pipeline that may change and improve the IAS return but there are also challenges posed by increasing build costs and also from the economic impact that Covid-19, Brexit and the conflict in Ukraine may have on the strategy.

The report highlights that the Council is in a relatively strong position with its investment

strategy, and this could result in a very strong balance sheet position going forward if the IAS performs well.

Recommendation(s)

Cabinet is recommended to:

(i) Approve the updated Investment and Acquisition Strategy 2022-27 at Appendix A to the report;

(ii) Agree the removal of Lease and Lease back asset class from the IAS and to the removal of external, inflation linked financing arrangements for IAS schemes, as outlined in section 1.15 of this report;

(iii) Note that the IAS forecast for 2022/23 was a surplus of £6.17m, which was £0.76m below its target of £6.92m;

(iv) Note that the IAS forecast for 2022/23 to 2026/27 was £30.38m, which was £4.23m below its target of £34.61m;

(v) Note the governance and controls in place to manage the IAS;

(vi) Note that gross and net developments costs increased by £100m between Gateway 2 and Gateway 4 and the impact on the IAS viability;

(vii) Note the amendments that have been made to the IAS assumptions as outlined in paragraphs 3.2 - 3.6 of the report, and their implications;

(viii) Note the requirement for commercial loans and commercial income to support the IAS, especially over the short-term; and

(ix) Note the impact of leverage on the IAS, as outlined in section 7 of the report.

Reason(s)

The proposals in this report will support the regeneration and economic growth of the borough and will help to support the long-term financial sustainability of the Council.

1. Introduction and Background

1.1 The Council's first Investment and Acquisition Strategy (IAS) was agreed by Cabinet in November 2016 as part of the Council's response to the unprecedented challenges it faced from Government cuts to public sector spending. The strategy has been subsequently reviewed a number of times, with the last review in October 2020.

1.2 The purpose of the IAS is to support the Borough's growth opportunities and to ensure that the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets. The scale of investment within the Borough is significant with in excess of 50,000 new homes to be built over the next 20 years accompanied by increased demand for employment space and

sustainable energy providing the Council with a key leadership and investment opportunity.

1.3 The IAS enables the Council to make investments that have the potential to support economic growth and / or deliver economic regeneration within the borough. In some cases, schemes with lower returns may be considered for strategic reasons. To accelerate the Council's regeneration, a development company, Be First, was created. They have reviewed and reconfigured the development pipeline, have brought new investment opportunities to the Council and have identified new asset classes to support private sector led regeneration.

1.4 In line with Government Guidance on Local Authority investment activities, this report provides an update on delivering investment objectives and sets-out the criteria to approve and finance investment opportunities going forward.

1.5 There are a number of other income streams and reserves that are linked to the IAS that support both the IAS and the Council. These are summarised below but are not included in the IAS forecast numbers within the report

i) **Capitalised Interest:** the IAS forecast does not include capitalised interest, which provides the council with a fairly short-term additional source of income through reduced interest costs. This has already been included in the MTFS and is principally there to cover the cost of carry-on future borrowing.

ii) **Muller Sale:** the sale of the Muller site will provide the Council with a significant one-off source of income. When the site has been sold then the net proceeds will be placed into an investment reserve.

iii) **IAS Reserve:** Currently the Investment Strategy has a reserve of £19.8m, as summarised below. The CR27 Reserve is for use only by CR27. The IAS specific reserve is currently £14.8m and is available to cover shortfalls from the IAS income and to fund expenditure to help improve asset management. The IAS reserve has also been used to fund shortfalls in company dividends over the past few years.

Table 1: IAS Reserve as at 31 December 2021

Reserve	Amount
IAS Reserve	10,997,682
Capital Investment Reserve	3,779,051
Total IAS Reserve	14,776,733
CR27 Reserve	5,000,000
Total IAS Reserve	19,776,733

1.6 The IAS is underpinned by complex financial and operational models. These models use a number of assumptions which have evolved as the IAS has matured ensuring that the IAS reflects reality and remains up to date. This report sets out where these assumptions have changed in response to external factors outside the control of the Council and the mitigations that are in place to maintain the viability of the IAS. In parallel, the continued success of the IAS relies on Be First and Reside operating effectively alongside the internal governance provided through the Investment Panel (IP) and the Shareholder Panel (SP).

1.7 Since 2019 and into 2022 the IAS has come under pressure from scheme delays and significant increases in build costs, high inflation and greater uncertainty over operational costs when schemes are let. The impact of this is to significantly increase the funding requirement of the IAS, increasing the risk profile of the strategy and a reduced forecast. These pressures have resulted in some schemes becoming unviable based on assumptions agreed as part of the 2021/22 IAS. Table 2 below shows the IAS forecast based on the September 2021 assumptions. It shows a large shortfall in return, with an accumulative deficit of £42m over the next 5 years.

Table 2: IAS Income Forecast 2022/23 to 2026/27 as at 30 September 2021

Years	2022/23	2023/24	2024/25	2025/26	2026/27	Total
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
IAS Target	-6,922	-6,922	-6,922	-6,922	-6,922	**-34,610**
Post GW4 & Turnkey	-1,423	-4,134	-1,707	-1,327	-697	**-9,288**
Reside (Current)	400	400	400	400	400	**2,000**
Commercial Income	800	800	800	800	800	**4,000**
Be First Commercial	1,329	1,329	560	560	560	**4,336**
Travelodge / CR27	1,115	1,197	1,197	1,197	1,197	**5,903**
Commercial Loans	0	870	589	303	0	**1,762**
Pianoworks	76	76	76	76	76	**378**
Expenses	-150	0	0	0	0	**-150**
Total (shortfall) / Surplus	-4,776	-6,385	-5,008	-4,914	-4,587	-25,670
Accumulative		-11,160	-11,393	-9,923	-9,502	**-41,977**

1.8 The impact of the increase in build costs was discussed at the September 2021 IP. Part of the discussion was on the change to regulations to allow greater use of Right to Buy (RtB) grant on affordable rent schemes, with the limit increased from 30% to 40%. In December 2021, IP agreed to use 40% RtB receipts for all schemes and this significantly improved the viability of the schemes.

1.9 The impact of build cost inflation has also been mitigated by a decrease in on-lending rate for the schemes when they are operational, but this has only been possible due to the treasury section locking in borrowing at low rates. It may not be possible for this option to be used in future given the current pressure on interest rates.

1.10 A number of other assumption changes were agreed by IP in December 2021, and these are outlined in more detail in the report. However, overall, the change in RtB and the reduction in interest rate has resulted in an improved position for schemes that are Post Gateway 4 (Post GW4).

Table 3: IAS Revised Income Forecast 2022/23 to 2026/27

Income Streams	2022/23	2023/24	2024/25	2025/26	2026/27	Total
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
IAS Target	-6,922	-6,922	-6,922	-6,922	-6,922	**-34,610**
Post GW4 and Turnkey	2,597	1,910	4,225	1,239	2,179	**12,150**
Reside (Current)	400	400	400	400	400	**2,000**
Commercial Income	800	800	800	800	800	**4,000**
Be First Commercial	1,329	1,329	560	560	560	**4,336**
Travelodge / CR27	1,115	1,197	1,197	1,197	1,197	**5,903**
Commercial Loans		870	589	303	0	**1,762**
Pianoworks	76	76	76	76	76	**378**
Expenses	-150	0	0	0	0	**-150**

Total (shortfall) / Surplus	-756	-340	924	-2,349	-1,711	-4,232
Accumulative		-1,097	584	-1,424	-4,059	**-5,996**

1.11 The figures in table 3 are net of borrowing costs (currently at 2%). Surplus income from on-lending is reported as part of the treasury outturn and will provide additional surplus in future years but there is some uncertainty over this due to the reduction in on lending rates. The figures also exclude surpluses that are allocated to Be First and expenses that are incurred, such as borrowing costs and security costs. The expenses included are contributions from the strategy towards a new build asset manager and the costs of handover programme management and monitoring in the council by My Place.

1.12 Currently there are pressures within the operational schemes that are managed by Reside. The pressure is from an increase in management and maintenance costs that are still to be confirmed; from bad debts, voids and the impact of inflation on Reside 1. There is also currently a lack of financial information available from Reside for the current schemes due to the focus on delivering Reside statutory accounts. An estimated £750k pressure/cost/income has been used for 2022/23 onwards for the current schemes (this excludes schemes that are operational from 1 April 2022 onwards).

1.13 Work is being carried out with Reside to improve their operational performance and a formal plan is under development. However, there is potentially additional expenditure required within Reside to improve reporting and monitoring.

1.14 Each income stream is covered in detail in the rest of the report, with greatest focus on the Post GW4 schemes and Turnkey Schemes as these are currently under construction and will form part of the IAS in the next few years. Pipeline schemes have not been included in the forecast as there is greater uncertainty over these schemes, with a number of the schemes unviable based on current assumptions.

1.15 Overall there is a shortfall in the forecast, especially in 2025/26 and 2026/27. While pipeline schemes, additional commercial income and commercial loans could close this gap, given the current pressures within the residential schemes, the position could worsen and currently there is greater monitoring of the impact of schemes to ensure that the forecast income can be achieved, but also that schemes can be transferred to Reside and the Registered Provider (RP) to be managed. For this to happen each scheme needs to be viable at a tenure level, with any unviable tenures, subsided by surpluses from other schemes. Work is being carried out with Reside to ensure that the current Post GW4 schemes and Turnkey schemes can be transferred when they are completed.

1.16 In 2021/22 a number of Temporary Accommodation (TA) schemes became operational and they were forecast to provide surpluses through the IAS to the Council. However, since they became operational forecast surpluses have reduced. Currently the three schemes, Weighbridge, Wivenhoe and Grays Court only provide sufficient returns to initially cover interest costs, whilst there is a need for the schemes to cover the debt repayments from year three in the IAS. As a result, the TA schemes are no longer part of the IAS but are part of the Council's capital programme managed by the TA service, currently forecast to operate at breakeven.

1.17 After schemes are completed, they are handed over to Reside, or in some cases the Council, and a Gateway 5 report, covering the development and then a Gateway 6 report, covering the first year of operation, is provided. Currently there are delays in providing the Gateway 5 reports and work is being carried out with Be First to improve the timeliness and usefulness of these reports to IP.

1.18 During 2021/22 a new system was introduced to provide enhanced monitoring of the development and their cashflows. The new system, SDS, has significantly improved the reporting and monitoring of developments. During 2022/23 work will be carried out to implement a reporting and monitoring system to provide information on the schemes when they are operational. It is expected that the development system and the operational system will link to provide complete details of each scheme. In addition, the IAS may need to fund additional resources to support the asset management and handover process to ensure properties are completed, transferred to Reside and then marketed and managed in an efficient and cost-effective way, as referred to in paragraph 1.10.

1.19 **Impact from Russian Invasion of Ukraine (update from Be First)**

1.19.1 A number of countries have imposed strict sanctions on Russia in response to its decision to invade its neighbour, causing the rouble to slump in value. There is likely to be some supply chain disruption as a direct consequence, but by far the greatest impact on UK construction is from an expected spike in oil and gas prices – while the UK does not import a huge amount of either commodity directly from Russia, its near neighbours do.

1.19.2 The UK doesn’t take a lot of Russian gas, but the inflationary impact on the global market will be felt across Europe and will impact the UK. The UK sources a lot of materials and components from Western Europe and there will be a higher and more prolonged inflationary impact. Many materials used in construction contain Petro-carbons or are very energy-intensive to manufacture and are soon likely to cost even more to produce and transport.

1.19.3 The pandemic has already tightened supply and ramped up costs. Construction material prices rose in 11 of the 12 months of 2021, according to an index published by the government, with contractors paying on average a fifth more for vital products and components at the end of the year than they were at the start.

1.19.4 The wider inflationary effects in construction are already a problem, layering on the impact of the war in Ukraine could be damaging especially if the Bank of England’s Monetary Policy Committee decides to put UK interest rates up quicker and harder than already planned. If Europe decides it is no longer going to take Russian gas, then the oil price will rise even higher and have a sharper impact on inflation. Contractors and their supply chains need to discuss their response.

1.19.5 Higher prices need to be passed on as the sector can’t absorb any more increases. Discussions will be needed as to who shoulders the cost of this inflation. If main contractors are squeezed in the middle, then it will have a direct impact on their levels of profitability and there are not huge margins on projects, so no slack to take up increased costs. After COVID there is a huge amount of demand for building to happen, not enough resource in terms of labour and big increases in material prices.

1.20 **Lease and Lease Back Asset Category**

1.20.1 Over the past ten years, Cabinet has agreed to invest in four lease and lease back arrangements including CR27, Isle of Dogs Travelodge, Reside 1 (William Street Quarter and Thames View East) and Trocoll House. These deals involve a lease and lease back arrangement with an Institutional Investor as the long leaseholder, with an inflation linked lease repayment due over an average 50-year period.

1.20.2 These schemes increase the Council's Capital Financing Requirement and are now viewed by HM Treasury as a form of borrowing. Agreeing future lease and lease back arrangements will mean that the Council will no longer be able to access PWLB borrowing, although this will not be impacted by current agreements.

1.20.3 These schemes increase the Council's exposure to inflation linked repayments and provide a long-dated obligation (of up to 50 years) with an institutional investor. The combined obligation of the four deals is over £330m, which is a significant exposure, given the current size of the IAS.

1.20.4 For these reasons, the Investment Panel has agreed to remove the lease and lease back asset class, including external institutional index linked borrowing, from the IAS list of investible assets. This decision can be reviewed in future but if agreed by Cabinet, investment proposals of this nature will not be considered.

2. IAS Borrowing Requirement and Interest Rate Pressures

2.1 The net borrowing for the IAS is significant, with the potential borrowing requirement of £3.0 billion. The breakdown of this borrowing is summarised in tables 1 and 2. Most of the borrowing is for residential schemes, with commercial schemes expected to be sold or developed as part of regeneration. The borrowing requirement has been split into a number of areas, including:

i) where they are being built (Post GW4 - Under Construction);
ii) where there has been a significant amount of pre-development expenditure, but final contracts have not been agreed (GW2);
iii) schemes not yet agreed and no significant expenditure incurred (Pipeline); and
iv) schemes that have been purchased as part of land assembly (commercial).

2.2 For schemes under construction (£625m), all of the long-term borrowing has been secured and if there were no further investments, the Council would not have a need to borrow further. Many of these schemes will be operational by 2023/24.

2.3 Schemes that are agreed but are not under construction (£396m) are under pressure as borrowing has not yet been secured (so there is interest rate risk) but also still require contracts to be tendered and will be impacted by the high build cost pressures. Improving the schemes viability could be achieved through increased grant, especially from the GLA but this will need to be confirmed prior to any additional schemes being agreed.

2.4 Pipeline schemes (£1,384m), includes a mix of Council led regeneration and turnkey schemes. Pipeline schemes do not include regeneration areas such as

Thames Road and, if agreed, will add many hundreds of millions of pounds more to the current total debt forecast.

2.5 Commercial schemes are a key driver of return for both Be First and the Council's IAS. Not all schemes, after debt costs, provide a profit but, overall, the commercial strategy provides a return to the Council through a margin on the interest and then to Be First from the surplus. The main contributors are Welbeck, Muller and Restore. The Travelodge hotels have not provided the expected surpluses but will provide positive returns for 2022/23 when the operator is paying full rent. Most of the commercial schemes will be sold or redeveloped but there is still some uncertainty over when this will happen.

2.6 At 31 December 2021, the Council had borrowed £729.4m, with approximately £225m of cash to fund the schemes currently under construction. With the schemes that are still undergoing design and planning, this will increase the borrowing within the general fund to £1.125bn and with the Pipeline schemes, this will increase to £2.418bn. With HRA borrowing included, this total potential borrowing would be nearly £3.0bn.

2.7 The borrowing does not include the exposure of the Council to the income strip deals and the external financing deals, including Reside 1 and Trocoll. These deals, especially the residential schemes, do expose the Council to expensive, inflation linked obligations, with Trocoll providing a number of years with negative returns that will need to be covered by profits from other schemes. These schemes also increase the Council's Capital Financing Requirement and will likely push this total obligation to nearly £3.5bn.

2.8 The report covers a number of areas where issues have been identified and corrective action taken to improve scheme viability. There remain concerns in PRS operational costs, build cost increases and the impact of high inflation. Interest margins have been decreased for several schemes to accommodate the worsening viability metrics. The worsening market conditions will impact pipeline scheme viability.

Table 4: Net Borrowing Required for Current and Pipeline schemes

Investment and Acquisition Strategy Forecast 10 Year Cashflow												
	Pre 2021	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31	Total
Post-G4	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**
12 Thames Road	8.69	1.09	32.69	7.35	-	-	-	-	-	-	-	49.81
200 Becontree Avenue	4.69	0.41	-0.01	-	-	-	-	-	-	-	-	5.09
A House for Artists	2.73	0.91	-	-	-	-	-	-	-	-	-	3.64
Crown House	34.20	25.76	-20.10	-	-	-	-	-	-	-	-	39.86
Gascoigne West Phase 1	47.12	32.60	-15.23	-1.96	-	-	-	-	-	-	-	62.54
Gascoigne West Phase 2	1.88	39.48	73.44	18.33	-3.32	-	-	-	-	-	-	129.82
GE Phase 2 Block C	-	23.28	-0.52	-	-	-	-	-	-	-	-	22.76
GE Phase 2 Block E2	-	47.02	7.96	4.95	-	-	-	-	-	-	-	59.92
GE Phase 2 Block F	-	37.80	42.99	-8.28	1.19	-	-	-	-	-	-	73.70
GE Phase 3A Block I	2.05	1.06	18.08	20.07	1.74	-2.00	-	-	-	-	-	40.99
GE Phase 3A Block J	-0.64	11.03	28.63	4.75	-11.15	-	-	-	-	-	-	32.62
Oxlow Lane	0.40	4.00	4.62	4.05	-	-	-	-	-	-	-	13.07
Padnall Lake Phase 1 (Infra)	1.64	2.67	11.26	8.03	-6.98	-	-	-	-	-	-	16.62
Padnall Lake Phase 2	0.21	3.97	7.58	1.93	-	-	-	-	-	-	-	13.69
Sacred Heart	9.89	6.41	-	-	-	-	-	-	-	-	-	16.30
Sebastian Court	18.60	-4.87	-	-	-	-	-	-	-	-	-	13.73
Woodward Road	4.35	7.12	4.21	1.00	-	-	-	-	-	-	-	16.69
Total Completed	135.81	239.75	195.61	60.21	-18.52	-2.00	-	-	-	-	-	610.86
Pre GW4	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**
Brocklebank	0.53	0.93	1.91	3.72	8.69	-	-	-	-	-	-	15.77
GE Phase 2 Block E1	0.02	4.89	21.62	35.15	-0.14	-	-	-	-	-	-	61.53
GE Phase 3B	0.86	2.33	9.60	50.95	59.74	3.62	-	-	-	-	-	127.10
Jervis Court	1.68	-0.79	13.06	2.20	0.00	-	-	-	-	-	-	16.16
Padnall Lake Phase 3	0.80	0.71	-3.51	1.10	34.08	-1.55	-	-	-	-	-	31.61
Roxwell Road	1.32	-1.37	9.49	4.14	3.07	-0.35	-	-	-	-	-	16.30
Total Under Construction	5.21	6.68	52.17	97.25	105.44	1.72	-	-	-	-	-	268.47
Turnkey	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**	**£ms**
Beam Park Phase 6	0.26	44.03	4.27	38.69	32.43	11.94	0.19	-	-	-	-	131.81
Beam Park Phase 7	-	17.71	0.15	29.04	8.51	13.81	13.56	14.84	-5.88	0.04	-	91.78
Chequers Lane	10.31	13.04	-7.90	0.16	-	-	-	-	-	-	-	15.60
Town Quay Wharf	-	-1.94	9.46	2.12	-1.42	-0.68	-	-	-	-	-	7.55
Transport House	1.53	-0.62	24.04	14.75	-4.99	-	-	-	-	-	-	34.72
Total GW2	12.11	72.22	30.03	84.75	34.53	25.07	13.75	14.84	-5.88	0.04	-	281.46

Pipeline	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms
Dagenham Heathway	-	-	-	12.52	6.31	6.15	-11.54	29.76	49.73	55.98	46.35	195.26
Gascoigne East Phase 4	-	-	4.83	10.76	8.26	74.29	75.71	-8.08	-	-	-	165.77
Gascoigne West Phase 3	-	-	1.89	2.49	2.77	25.29	25.59	-2.94	-	-	-	55.10
Heath Park Infill	-	-	1.35	1.97	2.22	19.10	42.76	-7.78	-	-	-	59.63
Hepworth Gardens-AR	-	-	5.00	-7.22	16.26	7.86	0.84	-	-	-	-	22.74
Ibbscott GW1	-	-	-	-	2.83	5.67	5.73	-5.77	44.97	64.15	64.79	182.38
John Burns Drive - AR & TR	-	-	0.73	1.26	0.80	0.47	-	-	-	-	-	3.27
Padnall & Reynolds	-	-	3.12	-11.56	45.22	46.38	18.11	-	-	-	-	101.26
Rest of Gascoigne West	-	-	-	-	9.99	8.02	8.27	8.17	28.87	101.42	122.78	287.51
Other Schemes	-	-	-	9.69	25.74	36.80	40.74	36.80	25.74	9.69	-	185.19
Total Pipeline	-	-	16.93	19.91	120.41	230.03	206.21	50.17	149.31	231.24	233.91	1,258.12
Total Residential	153.13	318.65	294.73	262.13	241.86	254.81	219.97	65.01	143.43	231.28	233.91	2,418.91

	Pre2021	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31	Total
Commercial	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms	£ms
23 Thames Road	5.60	0.13	-	-	-	-	-	-	-	-	-	5.72
26 Thames Road	4.44	1.31	0.10	-	-	-	-	-	-	-	-	5.85
3 Gallions Close	6.33	0.00	-	-	-	-	-	-	-	-	-	6.33
8 River Road - Welbeck	25.03	1.25	0.00	-	-	-	-	-	-	-	-	26.28
Dagenham Heathway	7.30	0.03	-	-	-	-	-	-	-	-	-	7.33
Film Studio	44.40		-	-	-	-	-	-	-	-	-	44.40
Industria	1.25	9.01	26.83	-	-	-	-	-	-	-	-	37.09
11-12 Riverside Industrial	0.60	-	-	-	-	-	-	-	-	-	-	0.60
1-4 Riverside Industrial	1.21	-	-	-	-	-	-	-	-	-	-	1.21
44-52 River Road	12.58	0.00	-	-	-	-	-	-	-	-	-	12.59
47 Thames Road	3.66	-	-	-	-	-	-	-	-	-	-	3.66
Barking Business Centre	27.70	0.05	-	-	-	-	-	-	-	-	-	27.75
Muller Site	47.92	-	-	-	-	-	-	-	-	-	-	47.92
Leisure Centre	-	0.05	3.82	17.34	-4.94	0.47	-	-	-	-	-	16.75
Travelodge - Dag East	7.25	-	-	-	-	-	-	-	-	-	-	7.25
GF Pianoworks	9.48	-	-	-	-	-	-	-	-	-	-	9.48
Total Commercial	204.76	11.83	30.75	17.34	-4.94	0.47	-	-	-	-	-	260.21
Total IAS	357.88	330.48	325.48	279.47	236.93	255.28	219.97	65.01	143.43	231.28	233.91	2,679.12

3. Cashflow and Performance Summary Update

3.1 Issues around the ability to fund the IAS were first raised in late 2020 and included:

- delays in scheme becoming operational causing a cost of carry pressure;
- a significant increase in build costs, which made unit sales unviable and reduced the margin on all schemes, but especially impacting London Affordable Rent (LAR) units due to the fixed grant;
- optimistic model assumptions both on rental inflation and on lifecycle costs;
- removal of sales and increased build costs increased long-term borrowing requirement, which increased the interest rate risk exposure for the strategy;
- a lack of income from alternative investments (commercial loans).

3.2 These pressures were mitigated in a number of ways, including:

i) capitalising of interest reducing the development period cost pressure caused by delays, the removal of sales and cost increases. Capitalising interest costs has increased the overall build costs, although by a relatively small margin;

ii) cost assumptions changed in October 2020 making schemes less viable but more realistically modelled, including:

- Short-term Interest rate increased from 1.5% to 2.0%;
- Long-term interest rate reduced from 3% to 2.75% for LAR schemes;
- MRP start date from year 2 to year 3;
- Operational cost inflation from 2.0% to 19/20 - 1.9%; 20/21 to 22/23 - 2.1% and 2023/24 onwards 2%;
- CPI for 80% rent & CPI+1% for LAR to 1/4/2024; then CPI to CPI+1% up to and including 31 March 2030 and then CPI thereafter for 80% and any social rent.
- Lifecycle costs from £1,440 per unit p.a. from year 5 after PC to £2,500 per unit p.a. from year 8 but to be overridden when QS LCC reports are agreed.
- Service charge of £20 smaller estates to £25 (larger estates) per unit per week for all tenures, changed to only private and SO.
- Separate out Public Realm costs from tenure figures.

iii) Alternative income from commercial schemes and Treasury outperformance.

3.3 Subsequently, development conditions have worsened, with Covid and Brexit both leading to a significant and sustained increase in build costs. A report was taken to IP in September 2021, outlining the impact of the cost increases, as well as the impact from a number of changes to assumptions.

3.4 The IP paper included a recommendation to:

- review assumptions for PRS, including inflation and management costs;
- reallocate HRA costs to LAR units;
- reduce LAR interest rate to 2.75% (from 3.0%);
- separately recording Public Realm costs; and
- review Shared Ownership (SO) first tranche assumptions.

3.5 Table 5 shows the figures taken to September IP for the schemes that had been agreed at Gateway 4, with negative cashflows in 10 of the first 15 years (the largest

negative year of £4.1m). There were significant negative cashflows for Shared Ownership and LAR and these negative cashflows impacted the total returns. It is important to note that the return target is not a £1 surplus but it is expected that the schemes provide £5.12m per year in surplus, although not all of this return will come from residential schemes.

Table 5: Post GW4 Cashflows over 20-years as at September 2021

Post Gateway 4 Schemes Net Surpluses Forecast as at September 2021								
	Total £'s	Market Rent £'s	Affordable Rent £'s	Shared Ownership £'s	London Affordable Rent £'s	Comm-ercial £'s	Parking £'s	Comm unity £'s
2021/22	-339,638	0	84,028	-39,589	-284,681	-246	-22,233	-76,916
2022/23	-1,422,562	-569,105	-8,201	-66,669	-689,026	9,808	-33,292	-66,077
2023/24	-4,133,958	-1,271,746	-69,261	-284,944	-2,359,069	1,188	-109,710	-40,420
2024/25	-1,707,209	101,187	628,558	-262,564	-2,446,457	436,398	-108,399	-55,927
2025/26	-1,327,028	363,528	742,067	-215,221	-2,493,126	436,565	-107,057	-53,784
2026/27	-697,435	631,375	940,468	-166,850	-2,387,437	442,293	-105,682	-51,596
2027/28	-685,609	860,939	776,162	-117,426	-2,496,304	442,470	-104,274	-47,177
2028/29	-1,575,575	855,882	166,128	-66,912	-2,952,083	568,671	-102,830	-44,432
2029/30	-2,089,575	726,718	-9,102	-15,291	-3,217,022	568,809	-101,352	-42,332
2030/31	-1,899,730	946,615	517	37,472	-3,312,121	568,951	-99,837	-41,321
2031/32	-1,420,169	1,178,089	144,431	91,409	-3,271,975	575,381	-98,287	-39,220
2032/33	-900,572	1,471,128	273,088	146,563	-3,235,985	575,533	-96,697	-34,199
2033/34	-248,156	1,721,160	422,531	202,959	-3,190,035	721,209	-95,069	-30,910
2034/35	202,602	2,006,363	518,179	260,646	-3,181,716	721,370	-93,400	-28,840
2035/36	517,183	2,237,176	575,798	319,668	-3,217,835	721,538	-91,691	-27,467
2036/37	1,047,155	2,513,863	731,379	380,066	-3,191,400	728,821	-89,941	-25,632
2037/38	1,674,049	2,863,535	889,950	441,902	-3,139,983	729,000	-88,147	-22,208
2038/39	2,225,845	3,112,371	969,691	505,228	-3,149,810	893,825	-86,310	-19,144
2039/40	2,805,222	3,427,878	1,133,071	570,113	-3,118,316	894,016	-84,427	-17,113
2040/41	3,476,242	3,807,996	1,299,760	636,629	-3,065,435	894,213	-82,499	-14,417
Total	**-6,498,918**	**26,984,952**	**10,209,242**	**2,357,189**	**-54,399,816**	**10,929,813**	**-1,801,134**	**-779,132**

3.6 Most of the deterioration in performance has been due to the increase in build costs, with both gross and net costs increasing on the post GW4 schemes by approximately £100m since GW2 (see table 6). The cost increases has impacted the LAR units the most, as they have a fixed grant amount and then the overall schemes. Schemes with a high LAR allocation are now generally not viable. Tenures need to be viable to be able to transfer the units into Reside or the RP.

Table 6: Gross and Net Development Costs GW2 to Latest (excluding pipeline schemes)

	Gross Development Costs				Net Development Costs		
Project	GW2 £Ms	GW4 £Ms	Latest £Ms		GW2 £Ms	GW4 £Ms	Latest £Ms
12 Thames Road	57.54	67.84	77.44		50.44	55.20	51.11
200 Becontree Avenue	5.41	7.52	7.92		4.88	5.77	5.09
A House for Artists	4.03	5.99	6.20		2.79	3.55	3.64
Crown House	44.35	60.71	61.88		42.10	40.75	39.85
Gascoigne West Phase 1	67.13	81.59	85.61		55.54	64.72	62.54
Gascoigne West Phase 2	155.22	165.91	165.91		53.46	133.61	129.82
GE Phase 2 Block C	20.29	20.29	31.07		10.52	13.17	22.76
GE Phase 2 Block E2	69.97	69.97	68.22		70.42	58.76	59.92
GE Phase 2 Block F	106.89	106.89	99.80		60.76	80.36	73.69
GE Phase 3A Block I	88.53	39.94	43.36		72.73	38.60	40.99
GE Phase 3A Block J	see Block I	48.58	50.58		inc. Block I	33.71	32.62
Oxlow Lane	15.21	22.08	22.53		9.93	15.24	13.07
Padnall Lake Phase 2	27.62	27.62	27.63		45.65	35.36	30.33
Sacred Heart	8.02	12.94	13.12		6.02	9.27	16.30
Sebastian Court	18.63	25.93	26.07		14.21	15.98	13.73
Woodward Road	20.48	21.22	23.37		15.19	16.38	16.69
Total Net Costs	**709.33**	**785.02**	**810.71**		**514.63**	**620.43**	**612.15**

3.7 For the Post GW4 schemes a number of additional changes have been made, following IP approval, to ensure that the schemes can have positive cashflows at a scheme and tenure level so that they can be transferred into Reside and / or the Registered Provider (RP). These changes, agreed specifically for the post GW4 schemes are summarised below and are outlined in greater detail in section 4:

i) Increase Right to Buy Receipts from 30% to 40%;
ii) Decrease on-lending interest rates from 3% to 2.75% for Affordable Rent (AR) schemes and to 2.25% for LAR, public realm, parking and community;
iii) Increased the GLA grant allocation where possible.
iv) Update lifecycle costs to reflect when cost incurred rather than the previous approach of smoothing costs – this results in a decrease in lifecycle costs in early periods but does result in some years having significant lifecycle expenditure.
v) Reside to arrange for SO schemes to be transferred to the Registered Provider to allow cross subsidy for LAR and Target Rent (TR).
vi) Increase operational costs for PRS schemes to reflects costs that would be incurred if an external provider were to manage the PRS units.

3.8 The impact of these changes has significantly improved the cashflow for all LAR, TR and AR but has made the cashflows worse for SO and MR, as shown in table 7 below. Overall, the schemes have positive surpluses but the SO, LAR and TR cashflows need to be improved to allow them to be transferred into the RP. As the interest rate that is charged for these schemes has been reduced to near the cost of borrowing in some cases it is essential that any S106, GLA grant or RTB grants that is available, is utilised for these schemes first. Negative cashflows from Parking, Community, PR and Commercial will need to be covered by the other commercial surpluses in the IAS.

Table 7: Latest Cashflows over 20-years (excluding pipeline and Turnkey schemes)

	Total	Market Rent	Affordable Rent	London Living Rent	Shared Ownership	London Affordable Rent	Target Rent	Parking, Community, PR & Commercial
2022	**2,344,600**	-141,992	1,582,970	41,046	541,704	276,899	12,460	31,513
2023	**1,631,192**	-287,854	2,533,117	53,455	-864,849	423,111	-92,942	-132,846
2024	**2,880,644**	712,278	2,771,526	-71,845	-45,653	347,332	-186,391	-646,603
2025	**1,046,346**	5,006	2,167,482	-58,604	-402,926	-1,864	-381,421	-281,327
2026	**804,599**	-163,023	2,266,901	-44,925	-354,284	-81,864	-368,341	-449,865
2027	**1,417,765**	102,361	2,467,569	-36,876	-304,548	-15,913	-357,325	-437,503
2028	**1,605,546**	299,618	2,463,480	-60,283	-253,694	-58,795	-362,371	-422,409
2029	**1,957,980**	485,253	2,498,920	-52,546	-201,688	-82,011	-384,544	-305,404
2030	**2,156,567**	689,535	2,517,606	-44,650	-148,508	-170,063	-385,477	-301,876
2031	**-976,077**	262,606	1,020,356	-335,240	-94,106	-1,034,680	-496,848	-298,165
2032	**423,369**	411,171	1,706,311	-28,388	-38,445	-707,168	-635,872	-284,240
2033	**2,052,093**	782,984	2,514,092	-49,783	18,512	-500,750	-448,887	-264,075
2034	**4,714,458**	1,851,721	3,227,512	-11,468	76,807	79,636	-378,835	-130,915
2035	**5,071,862**	2,204,131	3,256,025	-2,753	136,504	-41,795	-352,484	-127,766
2036	**-2,525,175**	934,990	-281,197	-694,707	197,639	-1,928,103	-627,463	-126,334
2037	**-39,226**	1,010,464	1,096,709	15,204	260,275	-1,388,265	-922,923	-110,690
2038	**3,841,579**	1,787,468	3,044,631	24,451	324,478	-765,604	-485,332	-88,513
2039	**8,735,220**	3,743,562	4,348,608	33,887	390,320	467,373	-310,362	61,832
2040	**8,773,747**	4,139,283	4,168,649	43,506	457,877	199,064	-301,161	66,529
2041	**-4,613,708**	1,819,532	-1,894,566	-1,073,598	527,234	-3,310,702	-752,773	71,165
Total	**41,303,381**	**20,649,094**	**43,476,701**	**-2,354,117**	**222,649**	**-8,294,162**	**-8,219,292**	**-4,177,492**

3.9 Turnkey Schemes (internally funded)

3.9.1 Turnkey Schemes are schemes that are purchased by the Council when they are built at a pre-agreed price and to a pre-agreed specification. This reduces the Council’s risk to build cost increases but does have certain limitations on how the schemes are built. The Council has two turnkey schemes already, Reside 1 and Abbey Road 2. Reside 1 is a turnkey scheme that has external funding and is covered in more detail in section 3.9. Abbey Road 2 is a turnkey that was funded by the Council and is a similar approach to the ones outlined in this section.

3.9.2 Initially, as part of the update to IP in September, turnkey schemes provided better cashflows, but a number of them were only marginally better and were not yet agreed. A number of schemes have subsequently been agreed, most notably Beam Park and there have also been updates to the assumptions used for the Turnkeys, including an increase in rents but also an increase in operational costs, due to most of the schemes containing a substantial amount of PRS units.

3.9.3 The initial cashflows are in table 8 below and show that the cashflows are mainly positive and even at tenure level the cashflows are positive. The table also shows that the combination of LAR, TR and SO provides provided positive cashflows. Although the cashflows are positive, the PRS units only provided marginally positive returns and if operational costs were to increase further, the PRS and many of the overall schemes cashflows would be negative.

Table 8: Cashflows for Turnkey over 20-years as at September 2021

Yar	Total	PRS	AR	SO	LAR & TR	SO, LAR and TR Combined
2021/22	**252,375**	-	195,003	-	57,372	57,372
2022/23	**278,924**	-	213,947	-	64,977	64,977
2023/24	**1,344,789**	-18,427	245,251	993,111	124,854	1,117,965
2024/25	**711,247**	8,930	278,007	278,795	145,515	424,310
2025/26	**1,336,247**	440,593	204,091	575,235	116,328	691,563
2026/27	**1,589,370**	581,502	228,799	619,186	159,883	779,069
2027/28	**698,298**	49,672	222,919	545,697	-119,990	425,707
2028/29	**953,097**	200,019	242,467	594,319	-83,708	510,611
2029/30	**2,015,543**	937,638	262,402	867,112	-51,609	815,503
2030/31	**1,459,612**	981,181	-148,167	941,722	-315,124	626,598
2031/32	**1,417,248**	745,765	165,817	848,974	-343,308	505,666
2032/33	**608,028**	198,507	153,906	929,399	-673,784	255,615
2033/34	**1,063,255**	450,566	202,998	1,029,828	-620,137	409,691
2034/35	**1,456,704**	711,088	222,151	1,111,893	-588,428	523,465
2035/36	**877,655**	980,348	-427,069	1,195,306	-870,930	324,376
2036/37	**1,544,934**	756,052	261,608	1,280,091	-752,817	527,274
2037/38	**1,958,011**	1,033,581	281,928	1,366,263	-723,761	642,502
2038/39	**2,382,875**	1,320,509	302,658	1,453,830	-694,122	759,708
2039/40	**2,819,873**	1,617,130	323,800	1,542,835	-663,892	878,943
2040/41	**1,668,259**	1,923,776	-744,409	1,633,281	-1,144,389	488,892
Total	**7,056,667**	**4,400,501**	**-110,715**	**17,806,877**	**-6,977,070**	**10,829,807**

3.9.4 Prior to Beam Park being agreed, the operational costs were remodelled, based on a report commissioned from Savills and this resulted in Beam Park being unviable as the operational costs significantly increased the management costs. However, an improvement in rent assumptions, based on some of the units being let at Beam Park, improved the cashflows and resulted in both improvements to the overall and PRS cashflows. This improved position is shown in table 9 below:

Table 9: Cashflows for Turnkey over 20-years latest Position

Years	Total	PRS	AR	SO	LAR & TR	SO, LAR and TR Combined
2021/22	**252,375**	-	195,003	-	57,372	57,372
2022/23	**278,924**	-	213,947	-	64,977	64,977
2023/24	**1,344,789**	-18,427	245,251	993,111	124,854	1,117,965
2024/25	**711,247**	8,930	278,007	278,795	145,515	424,310
2025/26	**1,336,247**	440,593	204,091	575,235	116,328	691,563
2026/27	**1,589,370**	581,502	228,799	619,186	159,883	779,069
2027/28	**698,298**	49,672	222,919	545,697	-119,990	425,707
2028/29	**953,097**	200,019	242,467	594,319	-83,708	510,611
2029/30	**2,015,543**	937,638	262,402	867,112	-51,609	815,503
2030/31	**1,459,612**	981,181	-148,167	941,722	-315,124	626,598
2031/32	**1,417,248**	745,765	165,817	848,974	-343,308	505,666
2032/33	**608,028**	198,507	153,906	929,399	-673,784	255,615
2033/34	**1,063,255**	450,566	202,998	1,029,828	-620,137	409,691
2034/35	**1,456,704**	711,088	222,151	1,111,893	-588,428	523,465
2035/36	**877,655**	980,348	-427,069	1,195,306	-870,930	324,376
2036/37	**1,544,934**	756,052	261,608	1,280,091	-752,817	527,274
2037/38	**1,958,011**	1,033,581	281,928	1,366,263	-723,761	642,502
2038/39	**2,382,875**	1,320,509	302,658	1,453,830	-694,122	759,708
2039/40	**2,819,873**	1,617,130	323,800	1,542,835	-663,892	878,943
2040/41	**1,668,259**	1,923,776	-744,409	1,633,281	-1,144,389	488,892
Total	**26,436,344**	**12,918,430**	**2,688,107**	**17,806,877**	**-6,977,070**	**10,829,807**

3.9.5 Combining Post GW4 Scheme and the Turnkey schemes results in improved, although still negative cashflows in LAR and TR. By combining these with SO the cashflows are still negative but additional grant or S106 money would result in all of the early years being positive and the accumulative being positive.

Table 10: Cashflows for Turnkey and Post GW4 over 20-years latest Position

	Total	PRS	AR	LLR	SO	LAR & TR	Parking, Community & Commercial	LAR, TR & SO combined
2022	2,596,975	-141,992	1,777,973	41,046	541,704	346,731	31,513	888,435
2023	1,910,116	-287,854	2,747,064	53,455	-864,849	395,146	-132,846	-469,703
2024	4,225,433	693,851	3,016,777	-71,845	947,458	285,795	-646,603	1,233,253
2025	1,757,593	13,936	2,445,489	-58,604	-124,131	-237,770	-281,327	-361,901
2026	2,140,846	277,570	2,470,992	-44,925	220,951	-333,877	-449,865	-112,926
2027	3,007,135	683,863	2,696,368	-36,876	314,638	-213,355	-437,503	101,283
2028	2,303,844	349,290	2,686,399	-60,283	292,003	-541,156	-422,409	-249,153
2029	2,911,077	685,272	2,741,387	-52,546	392,631	-550,263	-305,404	-157,632
2030	4,172,110	1,627,173	2,780,008	-44,650	718,604	-607,149	-301,876	111,455
2031	483,535	1,243,787	872,189	-335,240	847,616	-1,846,652	-298,165	-999,036
2032	1,840,617	1,156,936	1,872,128	-28,388	810,529	-1,686,348	-284,240	-875,819
2033	2,660,121	981,491	2,667,998	-49,783	947,911	-1,623,421	-264,075	-675,510
2034	5,777,713	2,302,287	3,430,510	-11,468	1,106,635	-919,336	-130,915	187,299
2035	6,528,566	2,915,219	3,478,176	-2,753	1,248,397	-982,707	-127,766	265,690
2036	-1,647,520	1,915,338	-708,266	-694,707	1,392,945	-3,426,496	-126,334	-2,033,551
2037	1,505,708	1,766,516	1,358,317	15,204	1,540,366	-3,064,005	-110,690	-1,523,639
2038	5,799,590	2,821,049	3,326,559	24,451	1,690,741	-1,974,697	-88,513	-283,956
2039	11,118,095	5,064,071	4,651,266	33,887	1,844,150	-537,111	61,832	1,307,039
2040	11,593,620	5,756,413	4,492,449	43,506	2,000,712	-765,989	66,529	1,234,723
2041	-2,945,449	3,743,308	-2,638,975	-1,073,598	2,160,515	-5,207,864	71,165	-3,047,349
Total	**67,739,725**	**33,567,524**	**46,164,808**	**-2,354,117**	**18,029,526**	**-23,490,524**	**-4,177,492**	**-5,460,998**

3.10 Turnkey – externally funded

3.10.1 Trocoll was agreed by Cabinet in March 2021 delivering strategic regeneration benefits within Barking town centre. The viability metrics used to assess the scheme have worsened since the Cabinet report. Whilst the scheme is forecast to deliver a surplus over the 50-year period, there are 12 years of deficit within the first 20 years with an accumulated peak deficit of £1.635m in year 18 (the accumulated deficit returns to surplus in year 29). The scheme does not now meet the key cashflow viability metrics. To avoid the Council incurring these deficits further work is required as set out below to improve the cashflow position, especially in the first 20 years, although there are some risks and pressures that could make the cashflows worse by the time the scheme is built. Any negative cashflows will need to be funded by surpluses in the rest of the IAS.

3.10.2 Unlike IAS schemes, for Trocoll it is not possible to reduce the interest margin or use RTB receipts should assumptions prove to be inadequate or if there are macro-economic pressures on the assumptions. Therefore, there is much greater emphasis on the assumptions used and detailed financial modelling.

3.10.3 There is a risk that as further clarification of costs is obtained, operational costs will increase further worsening the viability of the scheme. The lack of grant for the affordable units has made viability a challenge from the outset. If negotiations with the GLA proceed and are favourable, the grant received will improve the viability of

the scheme. Based on the current modelling, deficit years will need to be covered by the IAS, which is already under some pressure from other residential schemes.

3.10.4 The nature of this scheme is reliant on achieving the year 1 rental values when the units come onto the market in 2024. The rents included in the modelling are comparable to current prices charged in similar properties in Barking. If these prove to be prudent estimates and the units are let at higher rental values, the viability will improve.

3.10.5 A number of assumptions in the model have been revised during the due diligence process taking into account advice from parties who have experience of operating PRS/BTR schemes and in consultation with the Reside Board. The Council have not operated large PRS/BTR schemes and the assumptions used for IAS schemes are not wholly appropriate for this scheme and so have been revised. As estimated costs increase so does the risk that the surplus deteriorates and becomes a deficit, effectively costing the Council. The main assumption changes include:

(i) Increase in operational expenditure budget of £2.1k per unit per annum compared to IAS schemes, £401k total impact per annum. Out-sourced operational service used rather than Reside managing the units.

(ii) Lifecycle assumed costs were £33.9m over 50 years and are now modelled at £39.5m. Lifecycle costs are a key consideration for this scheme given it is situated above a station and has communal spaces that need to be maintained. In addition, the units need to be maintained to ensure they remain attractive for tenants.

(iii) Increase in void rate for PRS units from 1.5% to 3% (void rate for affordable units remains at 1.5%). One-bedroom apartments in the sector turn over occupiers more frequently than larger apartments which might incorporate families. Trocoll House contains a large proportion of one-bedroom apartments.

(iv) Increase in bad debt allowance for PRS units from 1.5% to 3%.

(v) The discount rate used in the NPV calculation has changed (as recommended in the Treasury Green Book) from 5% to 6.09%. This has differing impacts in scenarios that have been modelled but better suits the nature of the debt.

Trocoll Sensitivity Analysis

3.10.6 Sensitivity analysis has been carried out against a range of economic and operational conditions. While not all scenarios will have a negative impact on the scheme, generally the assumptions within the base scenario are optimistic and there is potentially more downside risk to the scheme, especially given current market conditions. In addition, it is likely that there will not just be one scenario that could impact the scheme but a combination. It is important to be aware of the impact on this scheme of these various scenarios. The final scenario below shows the impact of a number of negative assumptions in combination which is not unlikely to happen.

Scenario	Year one	Worst Year (ex Year 1)	NPV	Negative cashflow years	Peak Deficit (Cumulative)
	£000	£000	£000	(out of 20)	£000
DA Base position	-454	-454	1,400	14	-1,630
OpEx costs increased by 5%	-432	-386	600	14	-2,890
CPI increased to 2.5%	-417	-397	-1,700	14	-5,480
PRS inflation reduced to 2.5%	-456	-478	-3,800	14	-10,710
PRS rent reduced by 5%	-512	-478	-1,300	10	-5,350
PRS rent reduced by 2.5% and OpEx increased by 2.5%	-473	-434	-400	14	-4,100
PRS initial rent reduced by 2.5% and OpEx initial price increased by 5%	-491	-470	-900	15	-4,900
PRS rent reduced by 2.5%, OpEx initial price increased by 5%, 2.5% PRS rental inflation & 2.25% OpEx	-516	-590	-6,200	17	-23,350

3.10.7 The negative cashflows will need to be funded by the IAS and will add additional pressures to the IAS return. If Trocoll's actual performance is better than assumptions, then this will reduce the pressure on the IAS. However, if actual performance is worse than the current assumptions then this will put additional pressure on the strategy.

Table 11: Cashflows for All Turnkey and Post GW4 over 20-years latest Position

	Total	Trocoll	PRS	AR	LLR	SO	LAR & TR	Parking, Community and Commercial
2022	2,596,975		-141,992	1,777,973	41,046	541,704	346,731	31,513
2023	1,910,116		-287,854	2,747,064	53,455	-864,849	395,146	-132,846
2024	4,225,433		693,851	3,016,777	-71,845	947,458	285,795	-646,603
2025	1,238,718	-518,875	13,936	2,445,489	-58,604	-124,131	-237,770	-281,327
2026	2,179,083	38,237	277,570	2,470,992	-44,925	220,951	-333,877	-449,865
2027	3,083,520	76,385	683,863	2,696,368	-36,876	314,638	-213,355	-437,503
2028	2,402,254	98,410	349,290	2,686,399	-60,283	292,003	-541,156	-422,409
2029	3,031,307	120,230	685,272	2,741,387	-52,546	392,631	-550,263	-305,404
2030	4,315,160	143,050	1,627,173	2,780,008	-44,650	718,604	-607,149	-301,876
2031	648,465	164,930	1,243,787	872,189	-335,240	847,616	-1,846,652	-298,165
2032	1,487,535	-353,082	1,156,936	1,872,128	-28,388	810,529	-1,686,348	-284,240
2033	2,327,449	-332,672	981,491	2,667,998	-49,783	947,911	-1,623,421	-264,075
2034	5,464,056	-313,657	2,302,287	3,430,510	-11,468	1,106,635	-919,336	-130,915
2035	6,241,690	-286,876	2,915,219	3,478,176	-2,753	1,248,397	-982,707	-127,766
2036	-1,910,264	-262,744	1,915,338	-708,266	-694,707	1,392,945	-3,426,496	-126,334
2037	1,265,692	-240,016	1,766,516	1,358,317	15,204	1,540,366	-3,064,005	-110,690
2038	5,586,438	-213,152	2,821,049	3,326,559	24,451	1,690,741	-1,974,697	-88,513
2039	10,933,254	-184,841	5,064,071	4,651,266	33,887	1,844,150	-537,111	61,832
2040	11,439,818	-153,802	5,756,413	4,492,449	43,506	2,000,712	-765,989	66,529
2041	-3,067,876	-122,427	3,743,308	-2,638,975	-1,073,598	2,160,515	-5,207,864	71,165
Total	**65,398,821**	**-2,340,904**	**33,567,524**	**46,164,808**	**-2,354,117**	**18,029,526**	**-23,490,524**	**-4,177,492**

3.11 The cashflows in table 12 are the surpluses, by tenure and then by total of the schemes that the Council is building or has entered into a contract. These schemes will be completed and need to be profitable at both a tenure and combined level to allow them to transfer into Reside and the RP.

3.12 The cashflows are from schemes totalling £1.5bn and there is an expectation that the surpluses will be paid to Council by Reside and contribute to the £5.1m target.

3.13 Although there is some certainty over the build costs now the schemes are being built and, in some cases, are nearly complete, this has required a significant drop-in interest rate charged and there remains uncertainty over the operational costs, especially when the current high levels of inflation are taken into account.

3.14 Combining SO, LAR and TR improve cashflows but there are years with negative cashflows. To improve the cashflows requires additional grant and S106 funding.

Table 12: Latest Post GW4 Cashflows over 20-years – SO, LAR and TR Combined

Year	Total	SO	LAR
2022	888,435	541,704	346,731
2023	- 469,703	- 864,849	395,146
2024	1,233,253	947,458	285,795
2025	- 361,901	- 124,131	- 237,770
2026	- 112,926	220,951	- 333,877
2027	101,283	314,638	- 213,355
2028	- 249,153	292,003	- 541,156
2029	- 157,632	392,631	- 550,263
2030	111,455	718,604	- 607,149
2031	- 999,036	847,616	- 1,846,652
2032	- 875,819	810,529	- 1,686,348
2033	- 675,510	947,911	- 1,623,421
2034	187,299	1,106,635	- 919,336
2035	265,690	1,248,397	- 982,707
2036	-2,033,551	1,392,945	- 3,426,496
2037	-1,523,639	1,540,366	- 3,064,005
2038	- 283,956	1,690,741	- 1,974,697
2039	1,307,039	1,844,150	- 537,111
2040	1,234,723	2,000,712	- 765,989
2041	-3,047,349	2,160,515	- 5,207,864
Total	**-5,460,998**	**18,029,526**	**-23,490,524**

3.15 If the LAR, SO and TR returns can be improved to provide a small surplus within the RP then this will meet the regulatory requirements but would also allow the surpluses from the other schemes to be used to fund the IAS target of £5.7m per year. Table 13 shows the surpluses for the various tenures excluding SO, LAR and TR. This shows that most years provide a surplus but some years the surplus is minimal and only in a few, later years does the return get above the £5.7m target return. The GW4 and Turnkey schemes are not the only source of income for the strategy with income expected from commercial Schemes, current operational schemes, commercial Loans, Treasury management and the Investment Reserve.

3.16 Each of these can provide additional income to the strategy, with commercial schemes current contributing the bulk of the net income to the strategy. Each of these provides both opportunities and additional risks to the strategy. Where there is a shortfall then the investment reserve can be used to cover these, with the investment reserve there to smooth out the cashflows but to also provide some protection to the Council if there are short-term shocks to the IAS.

3.17 Section 5 to 7 goes into greater detail on the various additional IAS income streams, with section 4 summarising the various assumption changes made to the financial models and the impact that these have on the cashflows outlined in section 3.

Table 13: Latest Post GW4 & Turnkey Net Returns over 20 years against target return.

	Total	PRS, incl. Trocoll	AR	LLR	PCPC	Target Return	Shortfall / Surplus
2022	1,708,540	-141,992	1,777,973	41,046	31,513	5,700,000	-3,991,460
2023	2,379,819	-287,854	2,747,064	53,455	-132,846	5,700,000	-3,320,181
2024	2,992,180	693,851	3,016,777	-71,845	-646,603	5,700,000	-2,707,820
2025	1,600,619	-504,939	2,445,489	-58,604	-281,327	5,700,000	-4,099,381
2026	2,292,009	315,807	2,470,992	-44,925	-449,865	5,700,000	-3,407,991
2027	2,982,237	760,248	2,696,368	-36,876	-437,503	5,700,000	-2,717,763
2028	2,651,407	447,700	2,686,399	-60,283	-422,409	5,700,000	-3,048,593
2029	3,188,939	805,502	2,741,387	-52,546	-305,404	5,700,000	-2,511,061
2030	4,203,705	1,770,223	2,780,008	-44,650	-301,876	5,700,000	-1,496,295
2031	1,647,501	1,408,717	872,189	-335,240	-298,165	5,700,000	-4,052,499
2032	2,363,354	803,854	1,872,128	-28,388	-284,240	5,700,000	-3,336,646
2033	3,002,959	648,819	2,667,998	-49,783	-264,075	5,700,000	-2,697,041
2034	5,276,757	1,988,630	3,430,510	-11,468	-130,915	5,700,000	-423,243
2035	5,976,000	2,628,343	3,478,176	-2,753	-127,766	5,700,000	276,000
2036	123,287	1,652,594	-708,266	-694,707	-126,334	5,700,000	-5,576,713
2037	2,789,331	1,526,500	1,358,317	15,204	-110,690	5,700,000	-2,910,669
2038	5,870,394	2,607,897	3,326,559	24,451	-88,513	5,700,000	170,394
2039	9,626,215	4,879,230	4,651,266	33,887	61,832	5,700,000	3,926,215
2040	10,205,095	5,602,611	4,492,449	43,506	66,529	5,700,000	4,505,095
2041	-20,527	3,620,881	-2,638,975	-1,073,598	71,165	5,700,000	-5,720,527
Total	**70,859,819**	**31,226,620**	**46,164,808**	**-2,354,117**	**-4,177,492**	**114,000,000**	**-43,140,181**

4. Change in assumptions and approaches

4.1 The changes outlined in section 3.7 are outlined in greater detail below. These changes do impact pre-Gateway 4 schemes and pipeline schemes but have been fully implemented for the post-Gateway 4 schemes:

4.2 Increase Right to Buy Receipts from 30% to 40%

4.2.1 AR schemes have a number of negative years, mainly due to build costs increasing by more than the rental assumptions in the model. AR schemes are funded through the use of Right to Buy receipts (RtB), which is a limited grant, based on the sale of houses in the HRA. The Council receives £18m to £20m of net RtB receipts per year. Recent changes mean that Councils can use up to 40% of RtB receipts to fund schemes, which is higher than the previous limit of 30%.

4.2.2 All schemes were modelled at 30% RtB and so there is the potential to use more RtB subsidy to improve the viability. RtB receipts are limited to the amount received and held by the council. Using more RtB to make early schemes more viable may mean that there is insufficient grant for future schemes. AR units are the most viable tenure type as they have 80% rents but much lower net build costs when compared to other schemes (as this is reduced by RtB). They also have social housing costs for Management and Maintenance and are still attractive to people when compared to PRS units.

4.2.3 All Post GW4 schemes now have 40% RtB allocated to them and this has resulted in both the tenure returns improving but also the returns for the overall schemes moving from negative to positive surpluses.

4.2.4 For Pre-Gateway 4 and Pipeline schemes, currently there are a significant number of AR units assumed and using 40% RtB receipts will put pressure and limitations for these pipeline scheme. This is analysed in the table 9. Given the current pressure on PRS schemes, AR is the most likely replacement tenure and if AR is a limited tenure, then further consideration of tenure alternatives to PRS needs to be considered.

4.2.5 Table 14 shows that £22.0m per year is required and, even then, some of the potential pipeline schemes will not be able to be funded. At currently average RTB rates, it is likely that a number of schemes will not be able to have AR as a tenure or additional RtB will need to be obtain from the Government. As the table highlights, increasing RtB now will make schemes viable but may limit future schemes.

Table 14: RtB Required compared to RtB received per year (various estimates)

pipeline at 40%	£15.0m a year	£18.0m a year	£20.0m a year	£22.0m a year
Apr-21	70,888,498	70,888,498	70,888,498	70,888,498
Mar-22	63,120,223	66,120,223	67,120,223	70,120,223
Mar-23	29,565,684	61,351,948	37,565,684	43,565,684
Mar-24	-33,884,979	30,797,409	-21,884,979	-12,884,979
Mar-25	-28,989,089	-29,653,254	-12,989,089	-989,089
Mar-26	-24,149,892	-21,757,364	-4,149,892	10,850,108
Mar-27	-33,012,064	-13,918,167	-9,012,064	8,987,936
Mar-28	-44,712,064	-19,780,339	-16,712,064	4,287,936
Mar-29	-50,212,064	-28,480,339	-18,212,064	5,787,936
Mar-30	-81,212,064	-30,980,339	-45,212,064	-18,212,064

4.2.6 Pipeline schemes are summarised below showing the forecast use of RtB. The RtB requirement is significant, although some is only required in a number of years. For pipeline schemes, to accommodate the limited amount of RtB grant, some schemes will either need to be delayed further, more RtB needs to be obtained than currently forecast or the tenure mix will need to change to reduce the number of AR units.

Table 15: Pipeline Schemes with draft RtB requirements.

Pipeline Schemes	Total	25/26 £Ms	26/27 £Ms	27/28 £Ms	28/29 £Ms	29/30£Ms	30/31 £Ms
Barking Riverside DC	20.5	0	0	0	20.5	0	0
Dagenham Heathway	14.0	0	0	0	0	14.0	0
Hepworth Gardens	10.9	0	10.9	0	0	0	0
GE Phase 4	27.0	0	0	0	0	27.0	0
Heath Park Infill	4.0	0	4.0	0	0	0	0
Heath Park Redevel.	5.0	0	0	0	0	5.0	0
Padnall & Reynolds	26.7	0	0	26.7	0	0	0
John Burns Drive	1.6	1.6	0	0	0	0	0
Ibscott	18.0	0	0	0	0	0	18.0
Rest of GW	40.7	0	0	0	0	0	40.7
Stour Road 90	9.0	0	9.0	0	0	0	0

4.3 Decrease on-lending interest rates for AR schemes, LAR, public realm, parking & community

4.3.1 At the December 2021 IP, due to the pressures caused by the increased build costs, it was agreed that the on-lending rates to Reside of 3.0% (down from 4% in 2017/18) and 2.75% for LAR would be decreased to the following for Post Gateway 4 schemes:

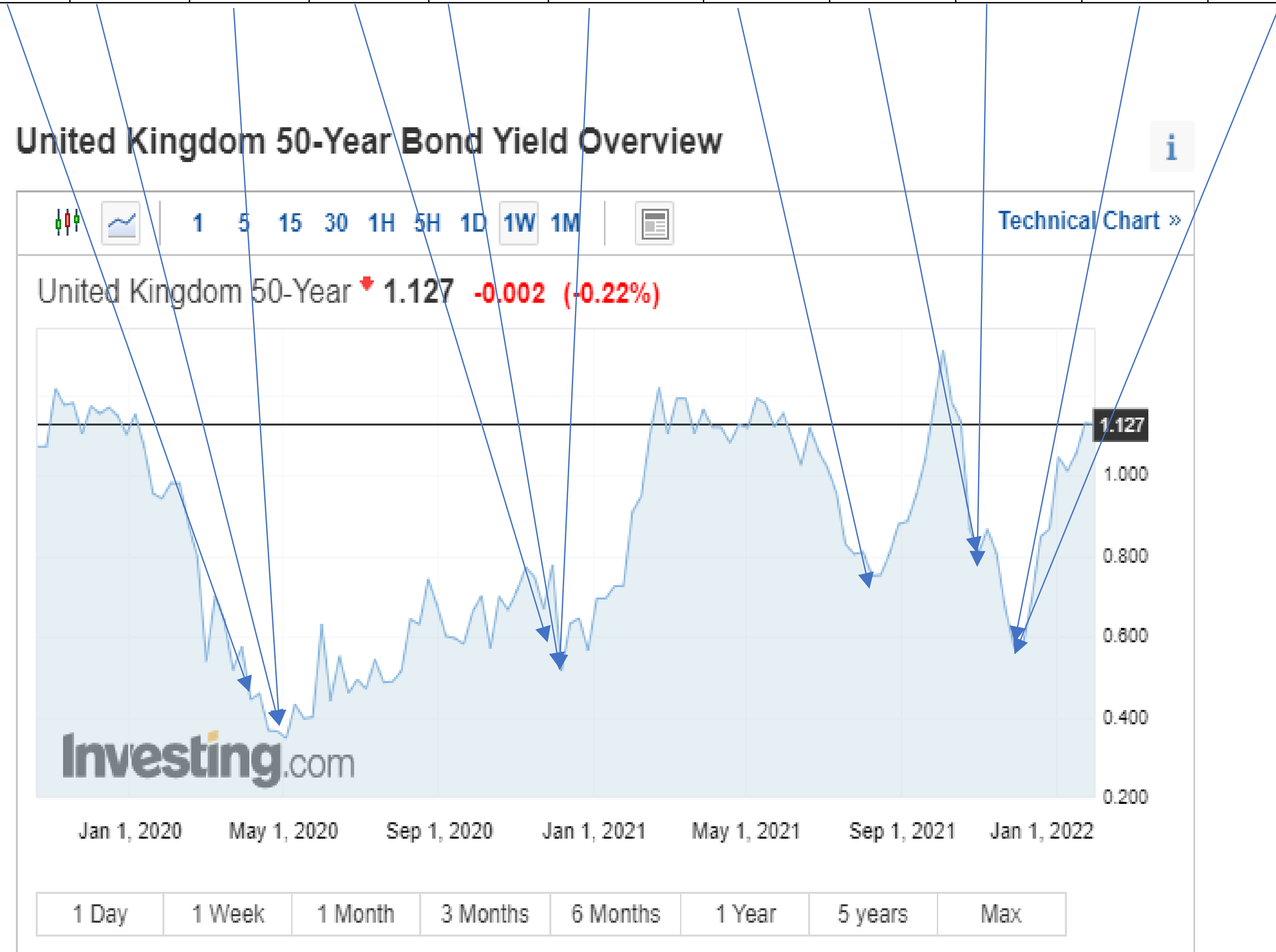
- interest rate on AR and PRS to 2.75%;
- interest rate on LAR, Parking, Community and Public Realm to 2.25%;
- interest rate on SO and Commercial remains at 3.0%

4.3.2 Dropping the margin for on-lending improves tenure viability but has implications for the Council. The main change will be on the surplus to the Council from the on-lending. Based on £610m of lending, a drop from an average of 2.95% to 2.60%, would reduce the interest margin from a theoretical £5.2m to £3.0m. This is when compared to the average borrowing cost of long-term general fund debt of 2.21%, at the end of 2020/21.

4.3.3 On-lending rates for post GW4 schemes can be reduced as treasury has managed to lock in low, long-term borrowing rates in 2021 as a result of the flight to safety within gilts. The deals completed since 2020 are summarised below and show that trades are generally completed when rates are low.

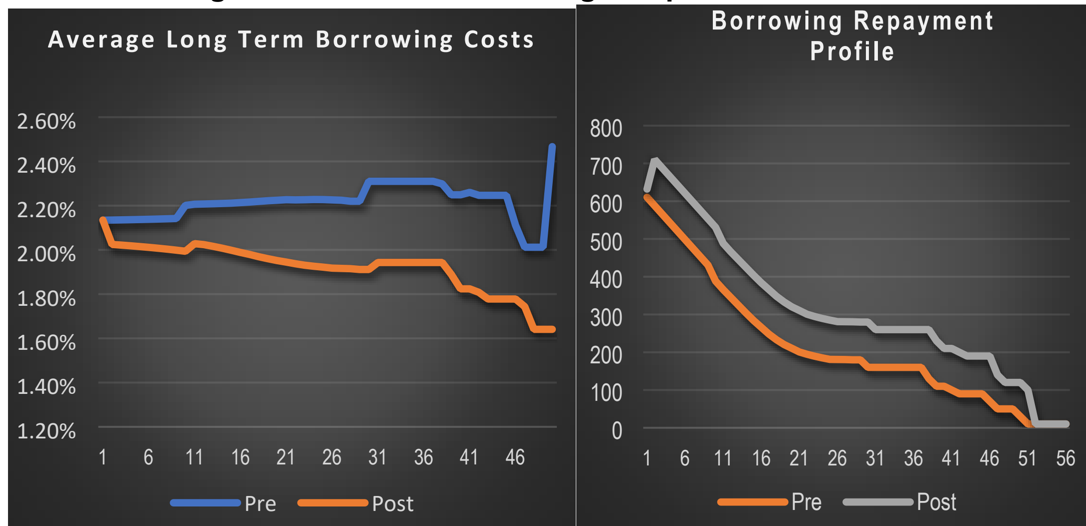
Table 16: Long-term borrowing 2020 to 2022

03/03/20	10/03/20	11/03/20	15/12/20	23/12/20	23/12/20	12/07/21	10/11/21	10/11/21	16/12/21	16/12/21
£20m	**£20m**	**£20m**	**£20m**	**£20m**	**£20m**	**£20m**	**£20m**	**£30m**	**£30m**	**£20m**
2.18%	2.06%	1.98%	1.33%	1.02%	1.50%	1.71%	1.51%	1.37%	1.31%	1.25%



4.3.4 The lower than forecast rates have dropped the annual average interest rate, as shown below:

Chart 1: Average Rate and total borrowing comparisons from 2020/21 to 2021/22



4.3.5 Not all the borrowing required for the agreed schemes is completed as yet and so pre-GW4 schemes and pipeline schemes would still need to meet the higher borrowing rates initially to be approved. In addition, interest rates have increased significantly over the past three months as inflation has resulted in the Bank of England increasing the base rates and Gilts increasing back to pre-covid rates. For pre-gateway 4 and pipeline schemes, this is a significant increase in risk, especially as most schemes have cashflows that have deteriorated from GW2 to GW4.

4.3.6 Reducing the on-lending rate was essential as the viability had deteriorated so quickly and by such a significant amount. This will reduce the interest surplus to the Council but should still provide a surplus and makes most of the tenures viable within Reside and the RP. The on-lending margin is also used by the strategy as a form of protection should assumptions be wrong in the financial models. Therefore, it has worked and has protected the strategy, but it does leave the Council vulnerable to further shocks that may impact the strategy.

4.3.7 Since December 2021, interest rates have increased as shown in the chart below. Currently the IAS does not need to borrow long term but will need to in the next two years or if the pipeline of schemes are agreed. If rates continue to increase then it is likely that interest rates will need to increase. Although this will make the viability worse for some schemes, the impact of increased borrowing costs should contribute to the reduction in build costs.

4.4 **Increase the GLA grant allocation where possible**

4.4.1 LAR schemes require grant to make them viable as rentals can be 50% of market rents. As build costs have increased, grant from the GLA for LAR schemes has remained at £100k and this has made this tenure unviable. The GLA has been asked to increase the grant, and Reside asked to look at cross subsidising with SO.

4.4.2 The GLA grant requirements are not confirmed but are required to make schemes viable. These are significantly higher than the £100k previously provided and there are added requirements when receiving additional GLA grant, with a move to Target Rent (TR) tenures rather than LAR tenures, with TR rents lower than LAR rents.

4.4.3 LAR units will be held within the Registered Provider (RP) and they need to provide a surplus and cannot be cross subsidised by other schemes, with the exception of SO schemes. SO units have positive cashflows that can effectively cross subsidise LAR units. Reside are currently looking into transferring the SO units into the RP.

4.4.4 Overall adding more grant to LAR schemes and moving SO units into the RP improves the position but there are still negative overall cashflows and the combined LAR and SO are still significantly negative, especially for post GW4 schemes. Only a reduction in interest rate charged will make them viable, unless additional grant was received. Given the current pressure on interest rates, this option will likely not be available for pre GW4 and pipeline schemes.

4.5 **Update lifecycle costs**

4.5.1 Lifecycle costs have been modelled as starting in year 8 and then an average per year is used for the next 44 years, which provides a smoothed cashflow, with some years having more provision and some years underproviding. This does result in increased cashflow pressure in the early years (years 8 to 14) but then when significant capital spend on schemes is required, this is absorbed within the cashflows.

4.5.2 This methodology has changed to reflect the actual lifecycle funding requirements. It results in improved cashflows for most years but negative cashflows for most schemes in a number of years. Given this approach reflects the actual forecast requirements and as schemes have start dates over a number of different years, this is the preferred approach to model lifecycle costs (agreed by IP in 22/12/2021).

4.6 **SO schemes to be transferred to the RP to allow cross subsidy for LAR & TR**

4.6.1 As outlined earlier in the paper, the LAR units do require cross subsidy as they are not viable as a separate tenure. SO can be held within the RP and can reduce the impact of the negative cashflows from the LAR units. Reside are currently working towards transferring the SO units to the RP (when it has been set up).

4.7 **Increase PRS operational costs for to reflects use of an external provider**

4.7.1 The iAS has seen a large increase in the number of PRS units, mainly driven by the move from sales. Sales were removed as units were costing more to build than they could be sold and this was identified prior to the most recent increase in build costs.

4.7.2 PRS has a number of specific issues as it requires more borrowing as there is no grant funding and has a different type of tenant – the tenures are shorter, which results in a higher void and letting costs. There has been some discussion with Reside, who were originally going to manage these properties and a proposed solution is for these to be managed by an external operator. Work has been done on these costs for Trocoll and Beam Park and then this will be done for the other schemes.

4.7.2 Both the council and Reside have not previously managed PRS properties. There is currently discussion around the best way they can be managed, with options around in-house and external management being discussed.

4.7.3 For the initial PRS units, they will be managed by an external operator. In-house provision could be a cheaper alternative, but it is important to ensure that the service provided is competitive in what is an established market. Reside will use external expertise to ensure that customers receive the level of service expected in this competitive market.

4.7.4 The financial models have used an estimate for an in-house provision and the costs being quoted for an external operator are higher than the modelled assumptions. For the figures in this report the external provider option is being modelled, which has reduced the viability for schemes with PRS.

4.7.5 If in-house management can be provided and it proves to be cheaper than an external provider then this will improve some of the schemes' cashflows.

4.8 Funding IAS assets held in the General Fund

4.8.1 Commercial, Parking, Community and Public Realm are retained within the GF, with interest internally charged at 2.25. A summary of the cashflows is provided below, with the majority of the commercial income coming from 12 Thames Road. The relatively small negative cashflows will be covered by the wider IAS.

Table 13: Commercial, Parking, Community & Public Realm Cashflows to 2039/40

Date	£26.6m	£3.4m	£10.4m	£20.3m	£60.7m
	Commercial	Parking	Community	Public Realm	Combined
2021/22	0	-4,897	-50,425	0	142,646
2022/23	9,284	9,453	-27,574	-13,790	439,773
2023/24	-181,040	17,303	38,016	-227,605	1,043,824
2024/25	263,965	13,403	27,275	-298,495	293,157
2025/26	63,570	-28,519	41,920	-411,634	-174,565
2026/27	43,483	-32,529	-30,020	-425,273	-281,780
2027/28	47,019	-31,113	-36,916	-434,671	-290,670
2028/29	173,181	-29,668	-34,855	-436,177	-160,029
2029/30	179,577	-28,194	-15,404	-437,680	-131,700
2030/31	179,679	-26,684	-14,841	-439,180	-128,495
2031/32	176,914	-25,145	-13,207	-440,674	-127,019
2032/33	183,251	-23,571	-9,635	-442,159	-114,441
2033/34	328,826	-21,962	-6,867	-443,633	36,639
2034/35	336,010	-20,317	14,788	-445,093	68,287
2035/36	336,073	-18,639	15,604	-446,537	72,041
2036/37	336,139	-16,923	16,860	-447,961	76,310
2037/38	343,318	-15,172	19,685	-449,362	89,339
2038/39	508,034	-13,381	22,126	-450,737	259,597
2039/40	516,172	-11,551	46,283	-452,080	295,071

5. Commercial Schemes

5.1 Commercial Schemes for the IAS are predominantly ones that have been purchased through Be First as part of estate renewal. Where a property is purchased through a Be First acquisition, a 3.25% interest rate is retained by the Council from the rental income to fund the borrowing costs and provide a surplus to the Council, which is then credited against the IAS target return of £5.7m. The expenditure, interest income and MRP set aside for each commercial holding is below. The borrowing costs to purchase these schemes is £2.14m based on a cost of borrowing of 2.0%, with a net surplus to the strategy of £1.33m.

Table 14: Commercial Schemes costs, interest and MRP amounts for 2021/22

Scheme Name	Costs	Gross Interest	Interest Margin	MRP
Welbeck Wharf	25,386,012	819,509	311,789	225,060
Travelodge Dagenham	7,253,389	235,507	90,439	64,305
Restore	12,586,691	409,031	157,297	111,587
9 Thames Road	4,858,573	156,144	58,972	-
23 Thames Road	5,724,526	184,730	70,239	-
27 Thames Road	601,935	19,563	7,524	-
47 Thames Road	3,664,500	119,096	45,806	-
BBC	27,758,221	901,427	346,263	-
Heathway	7,353,076	237,874	90,813	-
3 Gallions Close / 7 Cromwell	6,325,761	205,581	79,066	-
26 Thames Road	4,462,960	144,604	55,344	-
1-4 Riverside	1,206,640	39,216	15,083	-
Total Rent	**107,182,284**	**3,472,282**	**1,328,636**	**400,952**

5.2 Most of these schemes have been purchased as part of land assembly and where this is not the case, MRP has been set aside to repay the debt. A brief summary of each commercial holding is provided below:

i) **Dagenham Heathway**: purchased as part of a wider regeneration plan for the area. It has performed as expected although there have been issues with delays in payments.

ii) **Barking Business Centre:** purchased as part of land assembly for Thames Road. Is performing better than forecast.

iii) **Thames Road:** As GLA grant is not available now for the purchases, some of the units are under pressure but generally payment from existing tenants has been good.

iv) **Pianoworks / Travelodge:** Both schemes have struggled with the CVA agreement with Travelodge but this is coming to an end and returns are expected to return to the originally forecast amounts.

v) **Restore / Welbeck:** Performance is as per forecast, with additional spend on Welbeck expected to be funded by additional rental.

5.3 **Prudential Code and Commercial Borrowing**

5.3.1 CIPFA have revised the definition of investment within the Prudential and TM Codes, distinguishing between treasury and non-treasury investments, and recognising non treasury investments as either service or commercial investment.

5.3.2 Most of the Council's non-treasury investments are service investments but, from the IAS, Welbeck, Travelodge, Restore, CR27 and the Isle of Dogs Travelodge are commercial investments.

5.3.3 Under the Prudential Code and TM Code, LAs are required within their Capital Strategy and TM Strategy, to report on and clearly distinguish investments for treasury management, service and commercial purposes. The TM Code refers to the fact that LAs may "prefer to create a separate investment strategy for their service and commercial investments in order to maintain their separateness from treasury management investments and a requirement for Investment Management Practices (IMPs) has been introduced for non-treasury investments."

5.3.4 CIPFA have then interpreted legislation, as to what under the Prudential Code an Authority can borrow for, which aligns to the revised PWLB rules in that LAs must not borrow to invest primarily for financial return. However, the Prudential Code also recognises that LAs with commercial land and property may also invest in maximising its value, including repair, renewal and investment.

5.3.5 The changes from the Prudential Code are not retrospective, and para 53 states that LAs with existing commercial investments (including property) are not required by the Code to sell these investments (see below):

- **53** - Authorities with existing commercial investments (including property) are not required by this Code to sell these investments. Such authorities may carry out prudent active management and rebalancing of their portfolios. However, authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual treasury management or investment strategies. The reviews should evaluate whether to meet expected borrowing needs by taking new borrowing or by repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits. Authorities with commercial land and property may also invest in maximising its value, including repair, renewal and updating of the properties.

Interpretation of Prudential Code

5.3.6 On the basis that there is a legal commitment/agreement that was entered into prior to the 2021 Prudential Code, then these come under existing commercial arrangements, and therefore part of the historical position which then should be managed as part of the non-treasury investments going forward.

5.4 **Other Commercial Schemes**

5.4.1 There are a few additional schemes, including Pianoworks, which have been purchased or leased directly by the Council and for these schemes the full rental is allocated to the IAS, with borrowing costs going against the treasury strategy.

- **CR27 / Travelodge Income Strips:** CR27 is now performing as budgeted, and Travelodge should be completed in 2022/23. The contribution from the CR27 is £867k per year, which has been added to the overall IAS return target. The contribution from the Travelodge is £330k per year. There has been a delay in the completion of the Travelodge, with a likely date being Q2 2022.

- **Piano Works:** After a couple of difficult years due to the reduction in rent from some of the companies, the forecast for Piano Works is for a small surplus for 2021/22 and then a more meaningful contribution to the IAS in 2022/23.

Table 14: Other Commercial Income: 2021/22 and 2022/23

Other Commercial	2021/22 Forecast	2022/23 Original forecast
CR27	**867,000**	**867,000**
CR27 Budget	**867,000**	**867,000**
Variance	**-**	**-**
Isle of Dogs Travelodge	-	247,500
IoD Travelodge Budget	-	330,000
Variance	**-**	**- 82,500**
Pianoworks		
Travelodge Barking	302,346	355,701
Tesco	81,947	81,947
Explore Learning	23,954	23,954
Total	**408,247**	**461,602**
Interest Cost	- 308,014	- 305,479
MRP	- 78,001	- 80,536
Net (Surplus to IAS)	**22,232**	**75,587**

5.5 Commercial Lending – London Road

5.5.1 Cabinet agreed to enter into a joint development with Robyna Limited for a residential led scheme at London Road / North Street, Barking. As part of that decision, the Cabinet approved a loan of up to £35m to facilitate the development. The size of the development subsequently increased from 164 units to 196 units and Cabinet agreed to increase the size of the loan to £44m to cover the cost of developing the additional units.

5.5.2 The Development Agreement is subject to a number of Conditions Precedent, including the site being appropriated by the Council. Following exchange in late January 2022, the developer commenced the required notification and consultation exercise required before the Council can formally appropriate the site. This progress is ongoing and the Council is now expected to Appropriate early May with the condition to be cleared in August 2022 and construction will start soon after.

5.5.3 At this point a non-utilisation amount becomes payable. As the developer is required to use its own funds before the loan is drawn, the previous model shows the first drawn down in month 6.

5.5.4 Originally it was forecast that income would be received from the loan for 2022/23 but this has now been moved to 2023/24. This has had a negative impact on the IAS income, resulting in a forecast shortfall for 2022/23.

6. Funding the IAS (Proportionality)

6.1 Although the majority of the Council's investments are for regeneration and are within borough, an assessment of the Council's dependence on profit generating investments and borrowing capacity allocated to funding these, is considered against the lifecycle of the Medium-Term Financial Plan.

6.2 A four-year net interest forecast has been established by the Council within the Medium-Term Finance Strategy (MTFS), which will support the Council's investments but also at times may act as a limiter to its investment activities. To ensure that the level of borrowing is sustainable, the Council will invest in schemes that provide a positive return after all costs and will also ensure that it invests in a number of different asset classes and assets with different cash flows requirements.

7. Leverage

7.1 Combining the increased borrowing required with lower returns, as outlined in section 3, the net impact is an overall reduction in the rate of return. It must be highlighted that investment returns can improve or worsen and that, for the IAS, returns can be negative if there are significant voids or rental increases are lower than forecast.

7.2 Returns are exaggerated through using increased leverage (using more borrowing to receive a similar return). As such, while increasing leverage may provide a £6.9m return for the IAS the risk associated with meeting the cashflow requirements but also in repaying the increased debt, increases.

7.3 Table 15 below shows the impact that an increase in borrowing (shown by rent roll), reflected in an increase in rental and borrowing costs, can have should the strategy experience a period of reduced rental income.

Table 15: Rental

Impact on return of a 10% and 20% reduction in return for £31m rent and £3m profit					
Change	**Gross Rent**	**Lifecycle**	**MRP**	**Interest 3%**	**Profit/Loss**
Current	31,000	(8,500)	(4,500)	(15,000)	3,000
10% rental reduction	27,900	(8,500)	(4,500)	(15,000)	(100)
20% rental reduction	24,800	(8,500)	(4,500)	(15,000)	(3,200)
Impact on return of a 10% and 20% reduction in return for £48m rent and £3m profit					
Change	**Gross Rent**	**Lifecycle**	**MRP**	**Interest 3%**	**Profit/Loss**
Current	48,000	(14,000)	(7,000)	(24,000)	3,000
10% rental reduction	43,200	(14,000)	(7,000)	(24,000)	(1,800)
20% rental reduction	38,400	(14,000)	(7,000)	(24,000)	(6,600)

7.4 The impact of increased leverage can also happen without borrowing. This is through lease and lease back arrangements or other options where the Council

provides a return guarantee. This may not result in actually borrowing taking place, but the effect is the same as leverage. I.e. the cashflows to the funder are guaranteed by the Council but there can be significant risks to the Council from reduced rent or increased management and lifecycle costs.

7.5 The impact of leverage can be increased further by using inflation linked returns, both to the lender, where the pressure is to make ever increasing payment to the lender and then modelled for the rental income, where there is pressure to continue to increase rents by the same rate. It is for this reason that the strategy has a preference for fixed rate on all borrowing instruments to fund investments with a significant amount of social housing.

7.6 If the trend outlined in section 3 continues, then it may still be possible for the Council to make its £5.1m return based on a set of model assumptions but the level of debt taken to achieve this will be significantly higher than originally considered. This increased leverage will mean that the strategy has less flexibility and margin to cover significant pressures, such as a reduced rents, voids or bad debts.

8. Consultation

8.1 The updated IAS was considered and endorsed by the Investment Panel on 23 March 2022.

9. Financial Implications

Implications completed by: Philip Gregory, Chief Financial Officer

Development period and long-term borrowing

9.1 Due to the scale and timing of the development programme the initial schemes will be funded by borrowing from the Public Works Loan Board (PWLB). As the scale of development increases funding using institutional funders or bond issuance will be considered to limit the amount of development period exposure to the Council. This approach would allow the Council to limit funding to a defined development programme and to refinance schemes, subject to market conditions, when fully let and stabilised to release capital growth for reinvestment in other projects or elsewhere in the Council.

Medium Term Financial Strategy

9.2 The Council's balance sheet is currently £1bn in value. To fund the Investment Strategy, the Council will be heavily geared and the debt to asset ratio could be as high as 3:1 during the development period. This ratio will decrease as assets are built and let and are then included on the Council's balance sheet.

9.3 In line with the prudential code, the Council will need to demonstrate it can afford to carry the cost of borrowing to fund for both the construction period as well as the initial years before each of the schemes become cash flow positive. All borrowing will be profiled against the individual schemes, ensuring that the cash is available during the construction stage but that the repayment of the debt is included as the schemes generate income from rental and sales over the economic life of the asset. Borrowing will also be made over a period and will be dependent on the

requirement but may also be made as and when rates are low.

9.4 The Investment Panel will review all schemes and investment proposals individually based on the Terms of Reference previously agreed by Cabinet.

9.5 Property acquisitions may be held on the Council’s balance sheet or, where more financially advantageous, acquired through a Barking and Dagenham Reside SPV. Acquisitions will be supported by detailed legal and tax advice for each proposal.

10. Legal Implications

Implications completed by: Dr. Paul Feild, Senior Governance Lawyer

10.1 The Local Government Act 2003 is the key legislation for local authority investment regulation and section 15 of the Act requires that the Secretary of State issues Statutory Guidance on investments the most recent being issued in April 2018. For each financial year, a local authority should prepare an investment Strategy and follow disclosures and reporting requirements specified in the guidance. The Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

10.2 The Council has a wide range of powers concerning borrowing, investment and dealings with property which would empower the Council to pursue its Investment Strategy. Section 1 of the Localism Act 2011, the general power of competence (“GPC”) empowers local authorities to do anything that an individual can lawfully do provided that the activity is not expressly prohibited by other legislation. Activities authorised by the GPC can include investment, trading or charging decisions which may be undertaken through commercial (corporate) vehicles with the primary aim of benefiting the authority, its financial management, its area or its local communities. Whilst the General Power of Competence will permit the Council to invest in property for a return, such activity is likely to be deemed as ‘*activity for a commercial purpose*’ which cannot be undertaken directly by the authority and must be undertaken through a company structure within the meaning of section 1(1) of the Companies Act 2006 (s.4(2) Localism Act 2011).

10.3 Section 12 of the Local Government Act 2003 (“Power to Invest”) enables a local authority to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs. Speculative borrowing to invest purely for profit will not be deemed directly relevant to fulfilling the authority’s functions and will not, therefore, be authorised under this power, however, investment in land or property, for example with a view to regeneration, and in line with CIPFA’s Prudential Code for Capital Finance would enable the prudential investment of funds borrowed for the purpose of expenditure in the reasonably near future. The CIPFA Code contains detailed recommendations in the context of prudent borrowing practice, which should be considered as individual investment decisions are made. In exercising the power to invest under s.12(b) the Local Government Act 2003 the Council should have regard to the 2018 CLG Guidance on Local Government Investments. The Guidance advocates the preparation of an investment strategy which the Council is expected to follow in decision making unless sensible and cogent reasons exist for departing from it.

10.4 Section 1 of the Local Government Act 2003 (“Power to Borrow”) provides local authorities with the power to borrow for any purpose relevant to their functions under any enactment or for the prudent management of its financial affairs. The Power to Borrow has similar constraints to the investment power under the 2003 Act. Borrowing primarily to achieve a return is unlikely to be deemed connected to the functions of the Council or prudent financial management. Caution should be exercised in making individual decisions to ensure that new investments financed with borrowing do further the functions of the Council and are consistent with prudent management of the Council’s financial affairs.

10.5 Section 111 of the Local Government Act 1972 ("Incidental Power") enables a local authority to do anything (whether involving the expenditure, borrowing or lending of money) which is calculated to facilitate, or is conductive or incidental to, the discharge of any of their functions.

10.6 Investment and borrowing for the sole purpose of creating a return would not be deemed pursuant to the functions of the authority as required under the above powers. However, the report has clearly set out the primary objectives of the investment activity relate to shaping the strategic growth and economic development of the area to meet the needs of a growing local demographic and to shape local communities. Therefore, investment and borrowing in respect of property assets would be prudent and authorised pursuant to the authority’s functions, when used as regeneration tools, alongside other financial measures, to provide a suitable diversified housing mix for the growing local population, to regenerate local areas and to create employment and education opportunities. It is critical that the primary policy objectives of any investment activity, such as building new homes, regenerating an area or the creation of employment opportunities, are furthered and public funds are not exposed to unnecessary or unquantified risks.

10.7 Notably, many individual investment and acquisition decisions will be made in implementing the various strands of the Investment Strategy. Individual decisions will be taken by the Chief Operating Officer, advised by the Investment Panel, pursuant to delegated powers in respect of ‘corporate and strategic finance, treasury management, investments, and the capital programme…’ (Part 3, Chapter 1, paragraph 8.1(g) of the Constitution). To the extent that such decisions are key decisions, or urgent action is taken to acquire land (under paragraph 4, chapter 16, Part 2 of the Constitution) such decisions will be reported or notified to Cabinet in future reports. At all times, full consideration will be given to the Council’s powers of investment and acquisition, any relevant guidance such as the CIPFA Code and the overall aims of this Investment Strategy.

10.8 The Council’s Constitution, Part 4, Chapter 4 sets out the Land Acquisition and Disposal Rules. In accordance with paragraph 2.1, Part 2: Articles, Chapter 6 of the Constitution all key decisions and strategic decisions falling within the Land Acquisition and Disposal Rules as to the use, acquisition and disposal of land and property assets are generally within the remit of the Cabinet.

10.9 Formulation of strategic decisions is, at this time, overseen by the Property Advisory Group (PAG) and the Cabinet. Given the creation of the Investment Panel, to the extent that acquisition decisions are taken for investment purposes pursuant to the IAS, the Panel will advise and make recommendations as to such decisions either to COO (to the extent of the delegated powers available) or to Cabinet. Such

investment driven acquisition decisions, depending on the value of assets to be acquired may also be key decisions which would be publicised on the Council's forward plan of the decision. Decisions on strategic acquisitions pursuant to the Investment Strategy / IPA would be made by Cabinet or COO, advised by the Investment Panel, in accordance with the Council's Constitution and its Land Acquisition and Disposal Rules and the Scheme of Delegation. For the sake of efficiency, Cabinet is expected to approve an investment programme on a rolling basis (as set out in Appendix A) and to delegate any necessary authority to the COO, advised by the Investment Panel, to implement individual decisions in respect of individual schemes within the investment programme.

11. Other Implications

11.1 **Risk Management-** each potential investment and land acquisition opportunity will be subject to a full evaluation and risk analysis process as part of the IAS approvals process and scheme development Gateway review mechanism. This will be managed on behalf of Cabinet by the Investment Panel. The Investment Panel will be supported by external professional advisors

11.2 **Contractual Issues-** sites acquired in advance of planning permission being granted would be acquired under a Call Option arrangement or through outright purchase depending on the commercial evaluation and opportunity provided by each site. Each such proposed acquisition will be subject to the review process.

11.3 **Staffing Issues-** additional staff may be required to implement and manage the anticipated level of investment and consequent investment portfolio. Any additional staffing costs would be funded from investment returns.

11.4 **Customer Impact-** the proposals in this report would help to achieve the Council's growth objectives and would help to achieve financial sustainability of the Council. In addition, the investment and regeneration programme facilitated by the IAS will underpin the creation of new communities within the borough and will increase housing choices and housing affordability. In turn, this will help to address fuel poverty and help improve household health and educational outcomes.

11.5 **Safeguarding Children-** purchase of land in advance of planning permission could lead to the development of additional family housing which could improve help improve the life chances of children through a healthier environment and better domestic space in which to study.

11.6 **Health Issues-** provision of new housing has demonstrable health and wellbeing effects for occupants.

11.7 **Property / Asset Issues -** the proposals in this report will help the Council increase its affordable housing and income generating asset base. The proposals would also help to address physical and social obsolescence asset management challenges within the Council's existing property holdings and in the private sector.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix A: Investment and Acquisition Strategy 2022-27