Report to: Policy and Resources Committee, 4th February 2020

Report of: Corporate Director, Finance and Resources

Subject: CAPITAL AND INVESTMENT STRATEGIES 2020/21 – 2022/23

1. Recommendations

1.1 That the Committee recommends to Council that:

i. the Capital Strategy and Investment Strategy for 2020/21 – 2022/23 as set out in Appendices 1 and 2 be adopted;

ii. that the limit on the Development Fund be revised in accordance with the proposals set out in the report; and

iii. the Authorised Limit and Operational Boundary for external debt be revised in accordance with the proposals set out in the report.

2. Background

2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) has statutory responsibility for publishing guidance on local authority finance and accountancy. As part of the revised Prudential Code on Capital Accounting 2017 (published February 2018) CIPFA requires local authorities to publish a Capital Strategy which sets out the proposed approach to managing for capital expenditure in the next financial year and as part of medium-term financial planning.

2.2 The Capital Strategy must be reviewed annually and approved by Full Council before the start of the financial year. Its purpose is to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of the Council's services along with an overview of how associated risk is managed and the implications for future financial sustainability. Its purpose is to ensure that Members are fully informed of the plans and proposals with regard to capital spending, capital investments and the decisions taken in respect of them.

2.3 The Ministry for Communities and Local Government (MHCLG) has published guidance relating to capital investment strategies being followed by local authorities. This was prompted by concerns within central government regarding the extent to which local authorities are engaging in commercial investments, are using low-cost PWLB financing to generate a commercial return and are relying in such income to support services.

2.4 The guidance was issued under section 15(1)(a) of the Local Government Act 2003 and is effective for financial years commencing on or after 1 April 2018. It requires local authorities to publish an Investment Strategy alongside, or as part of, the

Capital Strategy as soon as possible within the financial year 2018/19 and to review these annually.

2.5 It should be noted, in particular, that the capital spend and income plans and the associated Prudential Indicators are based on known commitments. Proposals which may arise from the Development Fund agreed by the Policy and Resources Committee in July 2018 are included in these indicators where purchases have been approved. Separate reports relating to future proposals will be presented to Committee and, where necessary, Full Council, in due course, and the relevant reports will provide updates of the Prudential Indicators so that the impact of decisions can be assessed in the light of the Capital Strategy before they are taken.

2.6 Proposals that are currently under consideration will potentially need to be included in the capital programme as current and planned capital expenditure and may therefore be funded in part or whole form borrowing. In line with the Commercial Strategy, these investments will be for the purposes of supporting development within the City boundary or improving the well-being of Worcester's communities, while providing a return sufficient to cover financing costs.

2.7 To date one property has been secured under the Development Fund and a second is due to be completed in April 2020. A range of further proposals are now under consideration which will provide a broader mix of tenure types across different sectors, thus broadening the risk within the portfolio and increasing the Council's capacity to deliver its ambitious plans for the City, as set out in the City Plan and Masterplan. It is proposed that the upper limit on the Development Fund is revised to £80m to accommodate this strategy.

2.8 More detail on the reasons for this proposed changes are provided in the Capital Strategy but it must be emphasised that there is no commitment to spend up to this limit at this stage: each proposal will be considered on its own merits and will be subject to scrutiny by the Income Generation Committee and approval by the Policy & Resources committee, as set out in the Development Fund report, and subject to the risk assessment processes required by the Commercial Strategy.

2.9 Under the Prudential Code, the Council is required to set an affordable borrowing limit (also termed the authorised limit for external debt). In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. To provide sufficient headroom for the proposals outlined above, the Capital Strategy indicates that the Operational Boundary and Upper Limit for borrowing need to be revised in accordance with the table below.

2.10 The Council revised the Operational Boundary and Authorised Limit in October 2018 as part of the establishment of the Development Fund and further reviewed these alongside the budget report at its meeting of February 2019. However the limits must be reviewed annually as part of the prudential regime. The proposed limits set out in the table below include sufficient capacity to borrow to allow Development Fund proposals that are currently in discussion or may be brought forward during the years covered by the strategy along with other capital spend which may need to be funded from borrowing.

	2018/19 limit £m	2019/20 limit £m	2020/21 limit £m	2021/22 limit £m
Authorised limit	32.4	46.7	110.8	109.8
Operational boundary	26.8	39.2	103.1	102.5

3. Preferred Option

3.1 To approve the Capital Strategy for 2019/20 – 2021/22 and Investment Strategy for 2019/20 – 2021/22 and revised Operational Boundary and Authorised Limit for external debt.

4. Alternative Options Considered

4.1 The Capital Strategy and Investment Strategy are new documents for 2019/20 required under statutory guidance published by CIPFA and MHCLG. Alternative approaches to defined policies included in the strategies, such as the maximum level of the Development Fund or the level of capital expenditure to be incurred are considered as part of the individual reports for the relevant schemes.

5. Implications

5.1 Financial and Budgetary Implications
There are no direct financial implications arising from the strategies themselves, which set out the principles governing proposed capital expenditure and capital investment, other than those set out in this covering report. Any proposals for capital spending and, in particular, any proposals arising from the Development Fund or investments in third parties, will be subject to separate reports. Such reports will meet the criteria for clarity of purpose, risk assessment and formal financial evaluation as stated in the strategies.

5.2 Legal and Governance Implications
The Capital Strategy meets the Council's statutory obligations arising from the CIPFA Prudential Code on Capital Accounting 2017 and is subject to Full Council approval. The Investment Strategy meets the statutory guidance issued under section 15(1)(a) of the Local Government Act 2003.

5.3 Risk Implications
The Corporate Risk Register includes two relevant risks relating to the Council's overall finances:

- CRK-002 City Plan Priorities – Resources
- CRK-005 Local Government Funding.

The Commercial Strategy and Development Fund report highlighted the fact that the funding position for the Council is shifting from one based on central government funding to one based on income generated through local taxation and through fees and charges for services and investments. Relying on income from local sources is inherently riskier than relying on income from pre-determined government grants. The Capital and Investment Strategies are designed to ensure that these risks are fully considered and Full Council has full sight of those considerations.

A further corporate risk relates to the portfolio of 'commercial' investments that the Council holds:

- CRK-006 Investment Portfolio

This addresses the question of macro-economic changes, such as a recession, affecting the income levels generated by the portfolio. Some of the indicators in the strategies, particularly those showing the extent to which the Council is reliant on such income to support services, are designed to enable this risk to be assessed continuously and changes in the risk profile reported to Members regularly.

5.4 Corporate/Policy Implications

The Capital Strategy draws together the objectives and policy proposals set out in the Commercial Strategy, The Development Fund report, The Capital and Asset Management Framework and the Income Generation Strategy which were all published during 2018. These support the Council's objectives, set out in the budget report of October 2016, to increase income to mitigate the loss of central government funding though the revenue Support Grant. The Investment Strategy, similarly, is designed to work within the framework set out in these documents and under the strategic aims of the Capital Strategy.

5.5 Equality Implications

There are no direct equalities implications arising from the strategies. Any implications arising from specific proposals will be addressed in the relevant reports.

5.6 Human Resources Implications

There are no direct equalities implications arising from the strategies. Any implications arising from specific proposals will be addressed in the relevant reports.

5.7 Health and Safety Implications

There are no direct equalities implications arising from the strategies. Any implications arising from specific proposals will be addressed in the relevant reports.

5.8 Social, Environmental and Economic Implications

Capital investment provides opportunities for the Council to provide assets, improve infrastructure and facilities and support the development of services for the benefit of local residents, local businesses and local service users, including tourists. The Development Fund report makes clear that such investments must balance both the need to generate income with the opportunity to improve wellbeing for local people or enhance the local area. The Capital Strategy and Investment Strategy seek to implement this approach by demonstrating how the net financial benefits will be deployed to support services.

The Prudential Indicators included in the strategies enable Members to reach fully-informed judgements regarding the success of this approach and the risks associated with it and support effective decision-making. Individual reports regarding investment proposals will set out the benefits expected to arise from the investment of capital funds, including external borrowing. Each proposal must take into account two overarching criteria set out in the Commercial Strategy:

- Does the proposal include opportunities for local regeneration or enhanced services for target areas?

- Does the project generate secondary income for Worcester, such as business rates?

Successful implementation of the strategies will be measured by how far these overarching objectives are achieved as well as by how far the Council's financial stability is secured.

Ward(s):	**All wards**
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Background Papers:	**None**

Appendix 1

WORCESTER CITY COUNCIL

CAPITAL STRATEGY

2020/21 - 2022/23

DRAFT

February 2020

Introduction

This document sets out Worcester City Council's Capital Strategy. It gives residents and other stakeholders an overview of why, where and how we intend to spend money to provide services and meet some of the Council's wider strategic aims. Supported by other documents including the Asset Management, Treasury Management and Investment Strategies, it spells out our approach in the short, medium and long-term.

In particular, this document demonstrates how our Capital Strategy will help to deliver the five themes of the City Plan by:

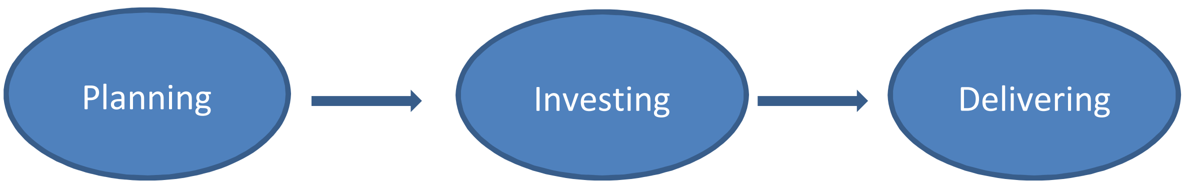
- investing in infrastructure and strengthening the Council's role in making our communities stronger and more connected
- delivering the Masterplan and regenerating High Streets to help secure a prosperous city
- supporting partners to develop facilities to help people become more healthy and active
- securing the heritage of the city for future generations
- acquiring and investing in Council assets to support service delivery.

How capital expenditure is defined

Capital expenditure is money used by the Council to acquire, upgrade, and maintain physical assets such as property, operational buildings and equipment. Capital expenditure can include everything from replacing a roof or purchasing a piece of equipment to buying an old building or constructing a brand new one. Capital expenditure is different to revenue expenditure, which is the money used by the Council for the day-to-day delivery of services, staffing and supplies.

Capital Strategy

In summary, our aim is to use the total capital resources available to create the best arrangements for meeting the aims of the City Plan. This means:



Planning: Following the publication of the **City Plan** in 2016 which set out our ambitions for the city, we have published a **MasterPlan** which details how we want to help shape Worcester for the future. We have also published our **South Worcestershire Development Plan** for consultation and identified sites in the city that can be brought forward for development.

Investing: we are targeting investment at strategic sites and looking to purchase properties such as **No.3 Kings Court** that will support engagement with partners and developers, give the Council a stronger stake in the city, and support further infrastructure and service development through income streams.

Delivering: we are working with partners to create new facilities such as a brand new **Hockey Centre**, refurbished swimming pool at **Lower Wick** and the new Football Association headquarters at **Claines Lane**: helping to address housing need through use of temporary accommodation at **Oldbury Road** and **Bromyard Road** and a new residential development at **Sansome Walk**: supporting businesses through investment in **Copenhagen Street**, the **Arches Worcester** and, if our bids are successful, through the Government's new **Towns Fund** and **High Street Fund**.

Our Capital Strategy will also help us meet our need to upgrade and maintain:

- Operational buildings
- Community facilities
- Our vehicle fleet
- Our ICT infrastructure.

To ensure that capital assets continue to be of long-term use, the Council has established a Capital and Asset Management Framework. This requires all assets to be subject to a five year 'fit for purpose' assessment which will determine whether the asset continues to meet the Council's needs and whether it should be retained or disposed of. Assets that are retained will have a detailed forward maintenance programme. A detailed Asset Management Plan, due to be published in March 2020, will set out these arrangements. The decision to acquire new assets, including property investments, will include assessment of revenue costs of maintaining the asset over its expected life.

Our duty to look after public money

As a Council, we have a duty to look after the public purse, and residents, businesses and the Government expect us to do so in a sensible and rational way. This Capital Strategy will demonstrate how we:

- Spend wisely and safely, especially in relation to the property portfolio that we hold under the Development Fund

- Finance our spending through prudent borrowing or use of reserves (called capital financing) within the upper level of our borrowing (called the external debt boundary) set by Council

- Manage risk and make decisions, ensuring we have the appropriate skills and expertise, and taking a measured approach to investment

- Ensure we have enough in reserves to keep services running and deal with any shocks to the system

- Maximise our returns on monetary investments, as set out in our Investment and Treasury Management strategies.

Underpinning the Capital Strategy is the need to ensure that the Council is financially sustainable in the future and able to meet forthcoming expected challenges to its Medium term Financial Plan.

Planned capital spending

Our aim is to: *spend wisely and safely, especially in relation to the property portfolio that we hold under the Development Fund*

Acquisition and development

In 2020/21, the Council is planning capital expenditure of £11.745m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 budget £m
General Fund services	4.613	7.532	3.084	2.091	1.563
Capital investments	0	10.264	8.661	0	0
TOTAL	4.613	17.796	11.745	2.091	1.563

The main General Fund capital projects include:

- Acquisitions of properties to support delivery of the City Plan and Masterplan
- Development of the Arches Worcester following a £3m grant from the Arts Council's Community Development Fund
- Clearance and preparation of the Sansome Walk site for housing development: £2.2m
- Housing Adaptations funded from Disabled Facilities Grants: £1.390m
- Full renewal of Council-owned and operated CCTV systems: £0.421m.

Capital Investments include property acquisitions (No.3 Kings Court in 2019/20 and one further proposed acquisition for which the price is agreed but which is still subject to completion). Both investments are office accommodation currently used by public sector organisations and therefore represent opportunities to strengthen public-partnership working for the benefit of the city.

Capital investments also include three proposed loans to non-profit making organisations to support the development of sporting facilities in the city. £2.1m is in respect of a loan to Worcester Hockey and RGS Worcester for the construction of an international-standard hockey centre at Droitwich Road. £750,000 is being made available to Worcestershire Football Association to support the development of their site at Claines Lane and £97,800 has been loaned to The Worcester Citizens Swimming Baths Association to help maintain and develop Lower Wick swimming pool so that it can continue to provide a space for local schools to train young swimmers.

Further investment in the acquisition of properties and in partnerships for the development of facilities are planned. These are considered in detail in the Investment Strategy 2020/21 to 2022/23.

The projected cost of the Arches Worcester project is £4.7m, of which £2.7m is capital spending. This is for the development of 6 railway arches between The Hive and Farrier Street and will include opening up the walkway from Foregate Street down to the riverside. The Council has made a contribution of £310k from its reserves to help finance this important development, which forms one of the key sites in the Masterplan.

The estimated preparation costs for the Sansome Walk site were set at £1.7m in line with advice received in relation to the likely costs of demolition. This was reported to Full Council at its meeting of 17 July 2018. Subsequent findings indicated that the demolition costs will amount to £2.5m. Once plans for the future use of the site have been determined, the full capital costs can be determined as these are dependent on the type of development required.

Prudent capital financing

Our aim is to: *Finance our spending through prudent borrowing or use of reserves within the upper level of our borrowing set by Council*

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenues, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing

	2018/19 actual £m	**2019/20 forecast £m**	**2020/21 budget £m**	**2021/22 budget £m**	**2022/23 budget £m**
External sources	1.964	1.883	1.455	1.320	0.695
Own resources	2.481	3.824	0.995	0.344	0.240
Debt	0.168	12.089	9.295	0.427	0.628
TOTAL	**4.613**	**17.796**	**11.745**	**2.091**	**1.563**

<u>Asset disposals</u>

When a capital asset is no longer needed, it may be sold so that the proceeds can be spent on new assets or to repay debt. Councils are currently also permitted to spend capital receipts on service transformation projects until 2021/22, but no projects are currently identified for capitalising in this way. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive capital receipts in the coming financial years as follows:

Table 3: Estimated capital receipts

	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 budget £m
Asset sales	0.999	0.163	2.827	1.254	0.240
Loans repaid	0	0	0	0	0
TOTAL	**0.999**	**0.163**	**2.827**	**1.254**	**0.240**

Asset sales are estimates only based on average sales in prior years and include the re-sale value of assets (such as vehicles and equipment) no longer required or replaced. Potential disposals will be notified to Policy and Resources Committee as and when identified.

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 4: Replacement of debt finance

	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 budget £m
Own resources	0.440	0.459	0.709	0.904	0.902

The Council's full minimum revenue provision statement is available at **Appendix A**

The amount that the Council needs to borrow to fund the planned capital programme is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £8.6 million during 2020/21 as MRP applied will be exceeded by new debt financing. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement

	31.03.19 actual £m	31.03.20 forecast £m	31.03.21 budget £m	31.03.22 budget £m	31.03.23 budget £m
General Fund services	11.230	22.833	31.415	30.898	30.583

Affordable borrowing limit

Under the Prudential Code, the Council is required to set an affordable borrowing limit (also termed the authorised limit for external debt). In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

The Council revised the Operational Boundary and Authorised Limit in October 2018 as part of the establishment of the Development Fund. However the limits must be reviewed annually as part of the Prudential regime.

The report of October 2018 set a limit on the Development Fund of £20m on the previously agreed requirement to generate income of £200k per year from such investments. However, the Development Fund proposals themselves take into account changes in the approach to such schemes, including the need to focus on local development rather than purely income generation. Therefore the scope of the Fund was broadened to increase the opportunities that were then available, rather than setting a limit based solely on the level of revenue income to be generated by the schemes. Accordingly, the limit on the fund was increased to £30m by the Committee at its meeting of 26 February 2019.

The successful acquisition of two properties under the Development Fund supports the twin principles of the strategy: to invest in the City and its assets in support of the wider aims of the City Plan and the Masterplan, as well as to generate sufficient income to cover costs and deliver the Council's ambitions. To build on this success, the Development Fund needs to be strengthened to build a wider portfolio of properties. It is proposed, therefore, to increase the Development Fund limit to £80m from 2020/21 onwards.

The Operational Boundary and Authorised Limit need to be reset accordingly. The proposed limits set out in Table 6 allow sufficient capacity to borrow to meet existing borrowing requirements (CFR 2020/21), anticipated financing needs in the subsequent two years and potential Development Fund requirements once these proposals are brought to fruition.

Table 6: Prudential Indicators: Authorised limit and operational boundary for external debt

	2018/19 limit £m	**2019/20 limit £m**	**2020/21 limit £m**	**2021/22 limit £m**
Authorised limit	32.4	45.7	110.8	109.8
Operational boundary	26.8	39.2	103.1	102.3

Borrowing strategy

The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between low-cost short-term loans and long-term fixed rate loans where the future cost is known but higher.

Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement.

Table 7: Prudential Indicator: Gross Debt and the Capital Financing Requirement

	31.3.2018 actual £m	31.3.2019 forecast £m	31.3.2020 budget £m	31.3.2021 budget £m	31.3.2022 budget £m
Debt (incl. leases)	7.334	7.293	9.402	21.454	19.121
Capital Financing Requirement	11.502	11.230	22.833	31.415	30.898

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term, to ensure that the Council is not borrowing in excess of its needs. As can be seen from Table 7, the Council expects to comply with this in the medium term. Any decisions made with regard to borrowing under the Development Fund will need to continue to meet this criterion. Therefore this Prudential Indicator will be revised and reported as such proposals are brought forward.

Risk management and commercial investment with appropriate skills and knowledge

Our aim is to: *Manage risk and make decisions, ensuring we have the appropriate skills and expertise, and taking a measured approach to investment.*

Investments for Service Purposes

The Council may make investments to assist local public services, including making grants to local service providers and local small businesses to promote economic growth. In light of the public service objective, the Council is willing to take more risk than with treasury investments. The details of the Council's risk approach to such investments is set out in the Commercial Strategy, approved by the Policy & Resources Committee at its meeting of 17 January 2018.

Decisions on service investments are made by the Corporate Director Finance and Resources in accordance with the criteria and limits laid down in the Investment Strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

Prudent commercial investment

With central government financial support for local public services declining, the Council has a greater need to ensure that where it invests in commercial property to promote economic benefits locally, or outside the Worcester City boundary, there is also a sufficient commercial return on that investment. Existing commercial investments in 2019/20 are currently valued at £15.110m, providing a gross income of £679,670.

In addition, the Council has invested £3m in the CCLA property Investment Fund. This is a fund which is based on income returns from a wide range of property investments. The returns are pooled and distributed to investors which must be Charities, Churches or Local Authorities. Anticipated income from the £3m investment in 2019/20 is £120,000 – a return of approximately 4.0%.

Where financial return is a significant objective, the Council accepts a higher level of risk on commercial investments than with treasury investments. A report on the establishment of a Development Fund approved by the Policy & Resources Committee July 2018 provides a maximum investment limit for the Fund. This is to ensure that such investments remain proportionate to the Council's size.

Principal risk exposures include: falls in the capital value of investment properties; increase in the costs of maintaining properties; void periods and other periodic reductions in income. These risks are considered and assessed as part of the proposal for each investment. Moreover a governance framework relating to risk has been established through the Council's Commercial Strategy (2018) and the Capital and Asset Management Framework (October 2018). The latter summarises the risk arrangements relating to the acquisition of Commercial assets:

"The primary objective of strategic capital spending is to acquire and dispose of assets and to maintain the value of existing assets, with the best possible financial benefit while ensuring the effective management of risk, in accordance with the following principles:

- *The purchase value of non-financial investment assets will not exceed the total value approved for the Development Fund*
- *Borrowing will not be undertaken to finance assets unless other options have been exhausted*
- *Assets will not be acquired unless there is reasonable assurance of sufficient revenue capacity to maintain the asset at its expected value during its lifetime*
- *Assets will be retained to the maximum life value and only disposed of when they have ceased to be fit for purpose (as opposed to adherence to fixed lifecycles)*
- *Planned and programmed maintenance will be co-ordinated to maintain the maximum value of assets over their lifetimes."*

Assessment of 'reasonable assurance' will be undertaken in consultation with professional experts, including the Council's Treasury Advisers, estate management experts and property professionals. No assets will be acquired without full financial assessment and survey of physical conditions, in accordance with the Commercial Strategy and the Policy and Resources Development Fund statement, July 2018.

Decisions on commercial investments are made by the Corporate Director Finance and Resources in line with the criteria set out above and limits approved by the Policy & Resources Committee. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

Further details on commercial investments and limits on their use are provided in the Commercial Strategy, Development Fund Statement and Capital and Asset Management Framework.

Managing reserves

Our aim is to: *ensure we have enough in reserves to keep services running and deal with any shocks to the system*

Revenue Budget Implications

To manage the risks relating to long-term investment, the Council needs to think about how much it is prepared to spend each year in interest payments and the repayment of debt. The amount set aside every year to repay debt is called the Minimum Revenue Provision (MRP).

The main overall limit is defined by the Operational Boundary shown in Table 6 which limits the amount of borrowing, and therefore the level of annual spending on interest and loan repayment.

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. This net annual charge is known as financing costs. The Council needs to be sure that its reliable sources of income are sufficient to cover these financing costs. The following table shows how the proportion of Council Tax, business rates and general government grants is to be spent on financing costs in the next three years.

Table 8: Prudential Indicator: Proportion of gross financing costs to net revenue stream

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Gross Financing costs £m	0.780	0.794	1.247	1.580	1.568
Net Revenue Stream £m	11.716	11.187	10.746	11.476	11.971
Proportion of net revenue stream	6.66%	7.10%	11.61%	13.77%	13.10%

Table 9: Prudential Indicator: Proportion of net financing costs to net revenue stream

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Net Financing costs £m	0.552	0.137	0.173	0.507	0.493
Net Revenue Stream £m	11.716	11.187	10.746	11.476	11.971
Proportion of net revenue stream	4.71%	1.22%	1.61%	4.42%	4.12%

This indicator is subject to change as a result of investments arising from the Development Fund proposals. However, the Commercial Strategy requires that any proposal must make a positive return over the lifetime of the scheme and a positive return over the first five years.

Managing Liabilities

In addition to debt of £7.3m detailed above, the Council is committed to making future payments to cover its pension fund deficit. It also maintains a General Fund balance to cover unforeseen risks and aims to hold reserves of £0.5m to mitigate reductions in planned income from activities and £0.7m to help manage reductions in expected business rates.

The Council is also at risk of having to pay for known contingent liabilities, which are reported as part of the Statements of Accounts. As at 31 March 2019 four of these were identified:

- Liabilities arising from the collapse of Municipal Mutual Insurance (MMI)
- Provisions for business rates appeals
- Provisions for personal injury claim pay-outs
- Sansome Walk site demolition costs.

In all cases the actual level of liability cannot be known and therefore specific level for any reserve cannot be identified. In addition, the MMI liability may be fully paid out (two payments have been made to date totalling £136,170) while the provision for business rates appeals is calculated as part of the budget estimates. This potential liability is therefore already allowed for.

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Corporate Director Finance and Resources is a CIPFA qualified accountant with over 20 years' experience in public finance, the Head of Finance is an ICAEW qualified accountant with a similar level of experience in both private and public sector organisations and the Head of Property is a Fellow of the Royal Institution of Chartered Surveyors and a Register Valuer. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA and ACT (treasury).

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, and engages with local property consultants according to the needs of each individual proposal. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Treasury Management

Our aim is to: *maximise our returns on monetary investments, as set out in our Investment and Treasury Management strategies.*

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. Revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, the Council currently has £7.3m borrowing at an average interest rate of 4.59% and (on average) £14.7m treasury investments at an average rate of 0.60%.

Liability benchmark

Under the Council's Capital and Asset Management Framework, approved by the Policy & Resources Committee at its meeting of 29 October 2018, external borrowing is only undertaken once all other forms of capital funding have been considered. Paragraph 10.4 of the Framework states that:

As the Council's borrowing limit is related to its revenue streams, and these are likely to remain restricted over the lifetime of this Framework, borrowing will be used only when other forms of financing are unavailable and principally only when financing an asset. Leasing will be considered as an alternative to borrowing to purchase in accordance with Strategy 4 but its use remains restricted by the same considerations of revenue impact.

The alternative is 'internal borrowing' whereby the Council uses cash reserves to fund capital expenditure which are then recovered over time through the Minimum Revenue Provision. The extent to which the Council is maximising opportunities for internal borrowing is considered as part of the Treasury Management Strategy Statement 2020/21 included as an appendix to the Budget Report.

Investment strategy

Treasury investments are necessary to ensure the prudent management of cash balances arising from receiving cash before it is paid out again. Investments made for service reasons or purely for financial gain are not generally considered to be part of treasury management.

The Council's policy on treasury investments is to prioritise security and liquidity over yield: that is, to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the short term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss.

Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both short-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Table 10: Treasury management investments

	31.3.2019 actual £m	31.3.2020 forecast £m	31.3.2021 budget £m	31.3.2022 budget £m	31.3.2023 budget £m
Near-term investments	13.4	7.2	7.8	7.0	7.4
Longer-term investments	3.0	3.0	3.0	3.0	3.0
TOTAL	**16.4**	**10.2**	**10.8**	**10.0**	**10.4**

Further details on treasury investments are included in the Treasury Management Strategy Statement included as an appendix to the Budget Report.

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director Finance and Resources and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to the Policy & Resources committee. The Policy & Resources Committee is responsible for scrutinising treasury management decisions.

Appendix A

Annual Minimum Revenue Provision Statement 2020/21

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Ministry for Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

The Council is recommended to approve the following MRP Statement*:*

For capital expenditure incurred before 1 April 2008 the MRP policy will be:

- A straight line repayment starting from 2016/17 of £114,060 which will repay the borrowing in 2047/48;

From 1 April 2008 for all supported and unsupported borrowing (including PFI and finance leases) the MRP policy will be:-

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations and with effect from 2016/17 the method of repayment will be through an annuity calculation (providing a consistent overall annual borrowing charge).

Capital expenditure incurred during 2020/21 will not be subject to a MRP charge until 2021/22.

Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2020, the budget for MRP has been set as follows:

	31.03.20 Estimated CFR (£m)	**2020-21 Estimated MRP (£m)**
Capital expenditure before 01.04.2008	3.308	0.114
Unsupported capital expenditure after 31.03.2008	19.530	0.595
Total General Fund	**22.833**	**0.709**

Appendix 2

WORCESTER CITY COUNCIL

INVESTMENT STRATEGY

2020/21 -2022/23

DRAFT

February 2020

Introduction

This Investment Strategy fulfils the requirement, under statutory guidance published by the Ministry for Communities and Local Government (MHCLG) in January 2018, to provide an overview of proposed service and commercial investments planned to be undertaken from 2020/21.

The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments)**,
- to support local public services by lending to or buying shares in other organisations **(service investments)**, and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy focuses on the second and third of these categories.

Treasury Management Investments

The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £7m and £20m during the 2020/21 financial year.

The contribution that these investments make to the objectives of the Council is to support effective treasury management activities. Full details of the Council's policies and its plan for 2020/21 for treasury management investments are covered in a separate document, published as an appendix to the Budget Report.

Service Investments: Loans

The Council has the opportunity to lend money to suppliers, local businesses, local charities, housing associations, local residents, its employees and its subsidiaries (should it have any) to support local public services and stimulate local economic growth. During 2020/21 The Council approved loan facilities for three community projects in order to unlock developments which might not otherwise have been possible.

- Worcester Citizens Swimming Baths Association - £97,800 to repair and improve the facilities at Lower Wick swimming pool
- Worcestershire football Association – Up to £750,000 for the development of the Headquarters and football facility at Claines lane
- Worcester Hockey and RGS Worcester – Up to £2.1m for the development of a new hockey facility to replace current deteriorating facilities

In each case the intention is to further the aims of the City Plan and use the Council's existing reserves, or its capacity to borrow, to support these objectives. In doing so the Council must have regard to regulations, CIPFA guidance, and legislation relating to State Aid. Under these rules the Council cannot use public funds above a certain financial limits to provide an advantage to a commercial entity which would otherwise need to obtain financing at market rates. However there are exemptions to these rules covering:

- Regional aid
- aid to SMEs in the form of investment aid, operating aid and SMEs' access to finance
- aid for environmental protection
- aid for research & development & innovation
- training aid
- recruitment and employment aid for disadvantaged workers and workers with
- disabilities
- aid to make good the damage caused by certain natural disasters
- social aid for transport for residents for remote regions
- aid for broadband infrastructures
- aid for culture and heritage conservation
- aid for sport and multifunctional recreational infrastructures
- aid for local infrastructure.

In any event it is essential to meet the terms and maximum aid amounts set out in the regulations.

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower need to be set. Table 1 shows upper limits on lending by type of provide. These limits are based on proposals under discussion as at the date of this report.

Table 1: Loans for service purposes

Category of borrower	**Proposed Limit 2020/21 £m**
Local charities	4.0
Housing associations	3.0
TOTAL	**7.0**

Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts from 2020/21 onwards will be shown net of this loss allowance in the event that loans are made. However, the Council makes every reasonable effort to collect the full sum leant and has appropriate credit control arrangements in place to recover overdue repayments.

The Council will assess the risk of loss before entering into, and whilst holding, service loans by detailed scrutiny of proposed cashflows of the loanee and by annual review of the loan arrangement. Individual reports for each proposal will set out overviews of such cashflows and identify potential risks in advance of any decision to proceed. All such decisions will be subject to agreement by the Policy & Resources Committee.

The following principles will form part of this strategy:

- Independent external advice will be sought and considered prior to provision of such loans
- Credit ratings will be used to asses risk where these are available and company financial assessments where appropriate
- Loans will be secured against appropriate assets and/or subject to guarantees in the event of default.

The statutory guidance requires that the Council Set limits on shares and other non-specified investments. The Council currently does not hold shares in third parties or subsidiaries and has no plans to make such investments, other than investment in the CCLA Property Fund. Investment in the fund as at 31 March 2020 is approved in accordance with the report agreed by the Income Generation Sub-committee at its meeting of 16 January 2018 with a maximum proposed investment of £5m. The current level of investment is £3m which is expected to generate a return of £120,000 (4%) in 2019/20.

Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition

Commercial Investments: Property

Statutory accounting definitions hold property to be an investment when it is held primarily for commercial purposes: i.e. to generate a profit. MHCLG guidance defines property to be an investment if it is held primarily *or partially* to generate a profit.

The Council currently invests in local commercial and residential property for a variety of reasons, according to historical decisions. The income derived from these sources in 2019-20 is budgeted to be £800k as set out in Table 2 below.

Table 2: Income from existing 'commercial' holdings

Type of holding	**Annual income (£)**
Industrial Estates	155,500
Markets	65,000
Offices	459,170
CCLA Property Fund	120,000
Total	**799,670**

Excluding those sites which are purely held for service delivery purposes, the book value of the investments defined as 'commercial investments' for accounting purposes during 2019/20 is £18.110m, providing a gross income of £799,670 p.a.

In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at, or higher than, its purchase cost including taxes and transaction costs.

Should the 2020/21 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to Full Council detailing the impact of the loss on the security of investments and revenue consequences arising therefrom.

The Council assesses the risk of loss before entering into, and whilst holding, property investments by reviewing the expected cash flows for each scheme under three scenarios: best, standard and worst case. The Commercial Strategy requires that only projects which meet the following criteria will be actively considered:

- The projected cash flows result in a positive outcome over the lifetime of the project under all recognised scenarios
- There is a positive return to the MTFP over the lifetime of the project
- There is a positive return, including use of contingencies, over the first five years.

Non-financial risks will be assessed in accordance with the Council's risk assessment procedures and a risk register compiled for each viable project that meets the qualification criteria established above.

Following the above assessment six weighted criteria will be used, as outlined in the Commercial Strategy. Projects falling outside these criteria will not be considered.

Two overarching criteria are also to be applied:

- Does the proposal include opportunities for local regeneration or enhanced services for target areas?
- Does the project generate secondary income for Worcester, such as business rates?

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. As the Council proposes to undertake such investment for regeneration as well as commercial purposes the option to sell the asset to recover costs must be balanced against the need to retain the asset to secure the development potential. The resale value is considered as part of the risk assessment for each proposal.

Should the costs of investment properties outweigh the income required to meet the financing costs of the investment, the Council will follow the strategic approach set out in its Commercial and Asset Management Framework approved by the Policy and Resources Committee on 29 October 2018. This requires that all assets, including commercial assets, are subject to a cyclical 'fit for purpose' review that 'invest or dispose' decisions are taken in the light of that review.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. These differ from service loans, outlined above, as they do not represent loans by the Council to third parties to support service delivery objectives as set out in the City Plan, Masterplan and Business Plan but underwriting financial commitments by third parties.

The Council has no existing contractual commitments to make financial guarantees to any organisations and does not propose to make loan commitments at this stage. The Council did make guarantee arrangements under the Local Council Mortgage Scheme (LAMS) but this scheme has now closed and all potential liabilities have ceased.

Proportionality

The MTFP approved by Council at its meeting in February 2018 included proposals for generating additional income from new sources amounting to £200,000 per annum from 2019/20. The Development Fund report set a limit of £20m on the Fund as this is sufficient, at 1% return including borrowing costs, to generate the required £200,000. If this objective is achieved the Council will be dependent on income generating investment activity to achieve a balanced revenue budget.

At its meeting of 26 February 2019 the Committee approved an increase in the Development Fund limit to £30m. A further proposal, to increase the Development Fund limit to £80m is included in the budget papers for approval by Full Council on 18 February 2020.

Table 3 shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net surplus from current 'commercial property' investments over the lifecycle of the Medium Term Financial Plan. It can be seen from the table that there is currently only a marginal reliance on income from these sources.

Table 3: Proportionality of existing 'commercial investments'

	2018/19 Actual £'000	**2019/20 Forecast £'000**	**2020/21 Budget £'000**	**2021/22 Budget £'000**	**2022/23 Budget £'000**
Gross service expenditure	24,101	22,352	22,487	22,983	23,516
Net return	321	752	436	432	432
Proportion	1.33%	3.36%	1.94%	1.88%	1.84%

Implementing the Development Fund report proposals in full would increase the extent to which the Council would be reliant on investment income to meet the costs of services, as shown in Table 4. This includes income from the CCLA Pooled Property Fund.

Table 4: Proportionality of proposed 'commercial Investments'

	2018/19 Actual £'000	**2019/20 Forecast £'000**	**2020/21 Budget £'000**	**2021/22 Budget £'000**	**2022/23 Budget £'000**
Gross service expenditure	24,101	22,352	22,487	22,983	23,516
Net return	321	752	989	1,031	1,031
Proportion	1.33%	3.36%	4.40%	4.49%	4.38%

It can be seen from Table 4 that reliance on income from commercial property investment will increase as a result of these proposed changes but remains proportionate to Council's finances as at the date of this report. The overall limit on risk arises from the upper limit on the Development Fund. Any change to this limit would affect the above indicator which, accordingly, will be reported should any change be proposed.

Borrowing in Advance of Need

MHCLG guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Development Fund report makes clear that the Council will not borrow purely for the purposes of investing to generate a profit but will seek to secure a reasonable return on its strategic investments. Paragraph 3.5 of the Development Fund report is as follows:

To progress its intentions under the October 2016 Cabinet report, therefore, the Council will need to ensure that either it invests existing resources in commercial activity (i.e. does not enter into borrowing for the purpose) and/or ensures that the investment is not solely for the purposes of generating profit. Currently, local authorities can purchase land, either within or outside the local authority area, 'for the purposes of....the benefit, improvement or development of their area' under Section 120 of the 1972 Local Government Act. The purchase and development of both land and building assets 'to encourage economic growth and a healthy and more active population' can be done under the general power of competence as these form part of the stated intentions in the approved City Plan.

The Council's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing are to:

- Maintain an overall limit on the Development Fund
- Budget on the basis of best, standard and worst case scenarios to ensure that income continues to exceed costs under all scenarios
- Undertake 'fit for purpose' reviews in line with the Capital and Asset Management Framework annually for investment properties
- Maintain adequate investment and sinking funds for each asset to mitigate additional losses
- Set an appropriate 'proportionality cap' to moderate the extent to which the Council becomes reliant on such income. It is proposed that this cap be retained at 5% as 2019/20 in respect of the 'proportion' row identified in Table 4.

Capacity, Skills and Culture

The decision to acquire land or property must be on the basis that it is a sustainable investment and therefore will be capable of generating an annual revenue return or a realisable capital receipt at a later date. The Council could take the decision to invest in property for the furtherance of the City Plan aims without expectation of a financial return but would at least need to realise the value of any purchase in its balance sheet. As this will require a clear decision-making rationale, the Development Fund report set out a two stage decision-making process to ensure that those responsible for making the decision had sufficient sight of the proposal:

- Stage 1: assess the potential of the proposed site both in terms of its contribution to the Council's aims and in terms of its financial return and make a conditional offer

- Stage 2: Undertake due diligence work and formally approve/reject purchase.

The Income Generation Sub-committee has responsibility for ensuring that these processes are followed and has the opportunity to scrutinise any proposal in detail. The Policy & Resources Committee will make the final decision on the basis of recommendations made by the Sub-committee. All proposals are subject to:

- Detailed review of proposed cashflows under best, standard and worst case scenarios
- Consideration of independent advice from third party experts on the viability of the scheme and the assessment of value
- Formal asset surveys and legal assessment to identify any risks inherent in the scheme

The indicators set out in this Strategy and the requirements of reporting in each individual proposal will ensure that elected members and statutory officers involved in the investments decision-making process have appropriate capacity and information to enable them to:

- take informed decisions as to whether to enter into a specific investment

- assess individual assessments in the context of the strategic objectives and risk profile of the local authority
- enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

All decision will be taken in line with the Development Fund report, the Commercial and Income Generation Strategies and the Capital and Asset Management Framework to ensure that due regard is made to statutory guidance as summarised in these documents, risk management, the possibility of financial loss and accountability for decision–making in respect of commercial investments.

Investment Indicators

It is proposed to set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions. Annual reports are proposed but more frequent reporting will be considered following regular risk assessment of the investment portfolio.

Total risk exposure: This shows the Council's total exposure to potential investment losses. This includes:

- amounts the Council is contractually committed to lend but have yet to be drawn down
    - Hockey Centre £2.1m, security to be held over the site covering the value of the loan. Risk therefore nil.
    - Worcestershire FA re site at Claines £0.75m, security to be held over the site covering the value of the loan. Risk therefore nil.

- the value of loans to be written off if the borrower were to default. This would be net of the amount realised from the sale of any land or property held as security;
    - Lower Wick swimming pool £0.1m. Risk £0.1m

- any guarantees the Council has issued over third party loans – none

- loss of rental income if the Council's tenants were to default and no replacement tenant could be found for up 12 months.

The last of these is now assessed as part of the scenario assessment for each Development Fund proposal. Specific risks relating to potential void periods, including those in excess of 12 months, are assessed and any proposals which do not meet the risk criteria set out in the Commercial Strategy are disregarded. To calculate an overall risk for the portfolio, the assessed risks for each proposal can be taken in aggregate and then moderated, over time, by past fluctuations in income or more detailed knowledge. The following table shows the current aggregate estimated risk of commercial property on this basis.

Table 5: Estimated risk of Commercial Property investments

Category	**Annual revenue 2019/20 £000**	**Calculated risk**	**Potential revenue risk £000**
Commercial property pre 2019/20	321	5%	16
CCLA Fund	120	5%	6
Development Fund	459	25%	115
Total risk exposure			**137**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with.

Since April 2007 the Council has not funded any investments through borrowing. Prior to that date, the cumulative figure for the underlying need to borrow does not provide granular analysis to identify individual assets.

During 2019 the Council has invested £10.1m as part of the Property Development Fund. To date this has been funded by internal borrowing.

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred. All individual proposals to be considered under the Development Fund will include this indicator as part of decision making, in accordance with the Commercial Strategy and Development Fund report.

- Gross return on current Development Fund properties: 4.87%
- Net internal rate of return on current Development Fund properties: 1.21%