Report to: Income Generation Sub-Committee, 16th January 2018

Report of: Head of Finance

Subject: INCOME GENERATION PROJECT UPDATE

1. Recommendation

1.1 That the Committee note the progress made in the project for Income Generation.

2. Background

2.1 The council has seen its funding reduced significantly in recent years and faces further reductions as the Government's Revenue Support Grant will be reduced to zero from 2019/20.

2.2 The council has begun a programme of transformation which is aimed at achieving a financial improvement of £2.8m over the three years from 2017-2020. This includes cost reductions from efficiencies and increased income from existing services.

2.3 The Income Generation project seeks to further develop existing services and identify new income opportunities with the aim of generating increased income for the council. A fund of £380k is set aside to finance any initial set up costs that may be required.

2.4 Funding of £50,000 has been approved for the appointment of an Income Generation Project Co-ordinator for 12 months to support the delivery of the project.

3. Information

3.1 As reported to the Committee at its October meeting, for the purposes of developing the Council's approach, income generation can be split into:

- Large projects – likely to be focussed on property, either developing existing land and buildings or acquiring new property.

- Smaller projects – this will include the development of feasibility studies into larger projects as well as smaller ones. There is likely to be a range of projects spread across the council. It is intended that some of these will grow and develop over time into a permanent income stream.

4. Large projects

4.1 Since the meeting in October the Council's Corporate Leadership Team have reported to Policy and Resources Committee on four developments of a significant scale.

- The publication of a brochure for the sale of Cathedral Square
- The potential development of the former swimming pool site at Sansome Walk in partnership with the YMCA
- The release of two parcels of land at the former Park and Ride Site in Perdiswell.

4.2 These matters were considered at the Policy and Resources Committee in October and November and resulted in the agreement of significant capital receipts for the two Park and Ride site disposals and an agreement of an exclusivity period for the YMCA to explore the option of using the Sansome Walk site.

4.3 Cathedral Square represented an opportunity for long-term income generation but it was considered that the scale of the purchase and the level of borrowing required placed the proposal outside the Council's acceptable boundaries of risk.

4.4 Irrespective of the decision not to proceed, a good deal of learning was obtained from the Cathedral Square project which can be carried forward into future potential property development considerations. This learning informed the proposed Commercial Strategy which is considered elsewhere on this agenda.

4.5 Meanwhile the Department for Communities and Local Government (DCLG) has published a consultation on proposed changes to the Prudential Framework on Capital Accounting which will have a direct bearing on property investments. This follows a related consultation by CIPFA on proposed changes to the Prudential Code which concluded on 30 September 2017 and which proposed the introduction of a Capital Strategy to be published prior to the start of the financial year.

4.6 The headline message in both the DCLG and CIPFA guidance is that local authorities will not be prevented from undertaking any form of investment decision but that there are considerably increased requirements to explain and justify the decision as well as set out actions to be taken if the investment does not generate the benefits originally expected. In particular, borrowing to invest in property outside of the local authority area (which is very difficult to justify on any grounds other than purely for income generation purposes) will be defined as 'borrowing in advance of need'.

4.7 At present 'borrowing in advance of need' is not prevented under the Prudential Code. However CIPFA is proposing an explicit statement regarding this in the consultation version:

"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. Authorities should also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds."

4.8 This is a significant change of position and while it will not outlaw investing in property outside of the local area, it will be very difficult to justify on the basis that it is not borrowing 'purely in order to profit from the investment'.

4.9 A more detailed summary of the CLG consultation is included at **Appendix A** along with commentary on the potential impact of the proposals.

5. Smaller projects

5.1 Income Generation Project Co-ordinator – this interim post was advertised externally resulting in four candidates being interviewed. Of these, the post has been offered to someone who has experience that closely matches the specification and who worked at a neighbouring local authority for several years.

5.2 A start date of 2nd January for a period of twelve months was agreed. However since then a significant personal issue has arisen for the candidate which has temporarily postponed the start date. The situation is now under review pending further information being received in early January.

5.3 In the meantime work has progressed on other income generation projects.

5.3.1 Guildhall room hire – in 2016/17 income from room hire at the Guildhall was £58k and is currently showing an increase of 10% year on year. The Guildhall team believe that there is potential to develop this further and are working on improving the marketing of the building. The websites and brochures of Guildhalls in other towns and cities have been reviewed to extract ideas and to compare prices. The team are currently working on a new dedicated website as opposed to being one of the services on the council's website and are also producing a new brochure which will be a significant improvement over the current paper leaflet.

5.3.2 Riverside – The Task and Finish Group have met and reviewed the current income generated from the council owned land and property adjacent to the river. Various opportunities to generate additional income were considered from both existing activity and from new initiatives. A walk of the riverside took place jointly with the council's Riverside Development Group, which includes several external stakeholders. This provided an ideal opportunity to review the practicality of these ideas in more detail. Two of the main opportunities are outlined below.

5.3.3 South Quay moorings – in recent years a small pontoon has been moored for the use of a boat to carry passengers on trips along the river. Negotiations are in hand to renew this for 2018, however the opportunity exists to use a larger pontoon and offer additional attractions e.g. small motor boats for private hire.

5.3.4 North Quay riverside café – the existing café at North Quay was originally the waiting room and toilets for the coach park. Hence it is quite small with limited cooking facilities, although it receives good reviews on social media websites. There is a small outside seating area. The site is adjacent to the coach park and the private moorings that run from North Quay up to the Rowing Club. It is owned by the City Council and the current lease ends in March 2018.

The site offers considerable potential being adjacent to Croft Road car park for parking and the attractiveness of overlooking the river. It could serve as a destination for:

- Boat owners using the council moorings on the river
- Coach parties arriving on or returning to their coaches
- Local residents seeking a scenic place for a drink and snack

There is sufficient outlying area to extend the premises or rebuild completely including an expansion of the outside seating area. The project would be funded by the council and would lead to an increased rent being received from whoever was selected to take the new lease on the property.

5.4 A project of this size would take several months to plan and obtain the necessary approvals. A short-term extension to the current lease would therefore be offered to the existing operator.

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Background Papers: **None**

APPENDIX A

Consultation on proposed changes to the Prudential Framework for Capital Accounting- Summary and Section 151 Officer Comments

The consultation was by the DCLG and concluded on 22 December 2017. It covers proposed revisions to:

- Statutory guidance on local authority investments
- Statutory guidance on Minimum Revenue Provision

This follows a related consultation by CIPFA on proposed changes to the Prudential Code which concluded on 30 September 2017 and which proposed the introduction of a Capital Strategy to be published prior to the start of the financial year.

The headline message in both the DCLG and CIPFA guidance is that local authorities will not be prevented from undertaking any form of investment decision but that there is considerably increased requirement to explain and justify the decision as well as set out actions to be taken if the investment does not generate the benefits originally expected.

Guidance on local authority investments

The Investments Guidance was last updated in 2010, following Parliamentary inquiries into local authority investments in Icelandic Banks. It therefore focused on investment in financial instruments. The department is seeking to re-focus on other forms of investment, including property.

The changes to the guidance will not reduce the flexibility that local authorities have to invest as they deem appropriate. The focus is on why an investment vehicle has been chosen and visibility of the potential impact of the decision on the organisation's finances, 'to make it easier for informed observers to understand how good governance and democratic accountability have been exercised.'

Authorities will also have to demonstrate that 'the level of debt taken on and aggregate risk is proportionate to the size of the authority and that they have considered the opportunity costs as well as the potential benefits of investment activities.'

Proposal 1
Councils will need to publish an investment strategy before the start of the financial year, as now, but can incorporate this into the new Capital Strategy proposed by CIPFA

Proposal 2
A statement of contribution to core functions

The guidance states that: 'The core function of a local authority is to deliver statutory services to local residents. Where a local authority chooses to invest in non-core activities and investments, it should disclose in its Capital Strategy the financial contribution that the activity or investment will make towards the delivery of core functions.'

More detail is required to understand what information needs to be disclosed but the change will enable stakeholders to view the return on investment (ROI) for each scheme proposed/and or the ROI for current schemes.

Authorities may need to explain that there are additional reasons for investing in a scheme where the ROI is lower than normally desirable. There are potential issues over commercial sensitivity if a proposal is still under discussion with the vendor/developer.

Proposal 3
Quantitative indicators will be included in the statement.

Specific indicators or thresholds will not be prescribed but they will need to be capable of showing year-on-year changes in the impact of investments on cash flows and pay-back periods over the lifetime of any loans.

This will highlight instances, for example, where a long term loan is taken out (to reduce annual financing costs) for a scheme with a relatively short pay back period.

Proposal 4
Extension of the principles of security, liquidity and yield to non-financial assets

CIPFA guidance in relation to financial investments is that authorities should prioritise security of capital first, liquidity second and consider yield as the third most important criteria. This tends to lead to investment in UK banks with high credit ratings and a significant amount of short term investments or loans (where the principal can be quickly recovered but are unlikely to generate high yields).

Applying such a risk hierarchy to non-financial investments is somewhat perverse as they are often long-term commitments. To address this, the guidance continues to allow local authorities to make their own investment decisions but requires a statement regarding impairment and how the authority will deal with it. i.e. if the value of an investment falls such that its sale would no longer cover the cost of the capital finance, how would the authority deal with this?

The liquidity principle is covered by a statement about the options for recovering the funds invested in a non-financial asset at short notice. This would normally be to sell the asset but, of course, that may not be sufficient if the asset has reduced in value. So commentary on alternative sources of capital to cover the impairment may be needed.

Also a risk assessment is required and a statement setting out actions taken to assess risk for each investment. This is designed to show that the risk assessment is robust and may include use of specialist advice.

Proposal 5
Introduction of the concept of 'proportionality' through a statement of the amount of income to be derived from non-financial investments and the amount borrowed to support this.

This is for transparency purposes which should enable stakeholders to compile a 'gearing ratio' for comparative analysis – i.e. how much is borrowing/investment income in proportion to the cost of services?

This change also requires statements of actions to be taken if yield does not arise as expected and of the opportunity cost of using the borrowing capacity for spending on services – this will be the ongoing revenue costs of borrowing to set against the yield information.

Proposal 6
Introduction of the concept of 'proportionality' through additional information to be provided where the borrowing has been undertaken solely to invest in an income-generating asset.

Borrowing to invest purely for the purposes of income generation is explicitly defined as borrowing in advance of need. The related CIPFA consultation states explicitly that 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."

This addresses the question of investing in property outside of the local area where there can be no additional benefits such as regeneration or inward investment of capital. The new statement will need to explain why this has been done 'in this instance' and what actions will be taken should the expected yield not materialise.

Proposal 7
Extends the principle that those involved in investment decisions should have sufficient knowledge and expertise to non-financial investments, including Council Members, corporate officers and 'other key indivduals'.

Guidance on Minimum Revenue Provision

Local authorities are normally required each year to set aside some of their revenues as provision for debt. More precisely, the provision is in respect of capital expenditure financed by borrowing or long term credit arrangements. This is referred to as a Minimum Revenue Provision (MRP).

The guidance was last updated in 2012. There are four changes proposed.

Proposal 1
Change in the definition of MRP from one that bears a relationship to the life of the asset to one that covers the gap between the need for capital financing and capital income from grants, receipts and other sources.

More clarity is need on the purpose of this change. However it may be designed to prevent MRP being spread over a longer period than the loan requires.

For example, MRP for a building is normally set for 40 years (the useful life of the asset). If £4m is borrowed over 40 years, then a straight line MRP would be £100k per year. If £4m is borrowed over 20 years, under current regulations, the MRP would be still linked to the life of the asset and spread over 40 years. Under the proposal, the MRP would be charged over 20 years (the life of the loan) rather than 40 years (the life of the asset) and would therefore be £200k per year, thus making the investment much less affordable.

There is nothing in the regulations, however, that attempts to define loan periods so the change in principle may be followed by subsequent regulations or it may be that it is designed to work retrospectively to apply to existing loans. This could be potentially very onerous and would need to take into account deferred borrowing (where the asset has been acquired through internal borrowing and the loan has not yet been taken out).

Alternatively it may be the intention to set the total of the borrowing and capital receipts as equal to the cost over the useful life of the asset. As before, if £4m is required and the useful life is 40 years, then, if capital receipts applied amount to £2m and borrowing is £2m (50% of total cost) then the MRP is charged at 50% of the lifetime of the asset – i.e. £200k per year.

As drafted, the proposal does not make it clear that this is the intention. Nor is an example provided of how it would work.

Proposal 2
Charge for MRP cannot be a negative charge

Where authorities have paid more MRP than necessary under the regulations they have sometimes made a reduced MRP provision in subsequent years to offset this which has resulted in a negative MRP charge to the accounts. The change will continue to allow offsetting charges for previous overpayments except where this results in a negative MRP charge overall. i.e. negative MRP charges will not be allowed.

Proposal 3
Restrictions on the impact of change in MRP methodology and requirement to demonstrate how a change is a prudent measure rather than being designed just to reduce MRP costs

There are several approved approaches to calculating MRP under regulations and authorities can change methodology if they wish. This will continue but will need to be justified. However, under the proposal any retrospective impact of a change will not be allowed. An example is given :

For example, if a local authority calculated MRP of £15m in 2013-14 and decided to charge £20m of MRP, it would have a £5m overpayment that could be offset against charges in future years. However, if the local authority changed its methodology in 2016-17 and based on the revised calculation determined that it should have charged £12m in 2013-14, it would still have a £5m overpayment that could be offset [not £8m].

Proposal 4
Introduction of a maximum asset life of 40 years for buildings and 50 years for land

This is to prevent MRP payments being reduced by spreading them over a longer period.