City of BRADFORD
METROPOLITAN DISTRICT COUNCIL

Report of Finance to the meeting of Executive to be held on 24 March 2020

BI

Subject:

The Council's Capital & Investment Strategy 2020-21

Summary statement:

This report proposes the Council's revised Capital & Investment Strategy 2020-21 for approval by the Executive.

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Portfolio:

Leader of the Council

Overview & Scrutiny Area:

Corporate

1. SUMMARY

This report proposes the Council's revised Capital and Investment Strategy 2020-21 for approval by the Executive.

2. BACKGROUND

The Council's revised Capital Strategy 2020-21 is presented in Appendix 1 of this report.

The Council's Investment Strategy 2020-21 is presented as Appendix 2 of this report.

3. OTHER CONSIDERATIONS

None.

4. FINANCIAL & RESOURCE APPRAISAL

The financial implications are set out in Sections 4, 5 and 7 of Appendix 1.

5. RISK MANAGEMENT AND GOVERNANCE ISSUES

Risk Management and Governance issues are set out in Sections 3 and 7

6. LEGAL APPRAISAL

A legal appraisal of the issues raised by the proposed amendment to the current Capital Strategy is set out in the body of the report. Legal Services will provide further advice on the implementation of the Capital Programme as required.

7. OTHER IMPLICATIONS

The implications of the strategy on considerations relating to equality and diversity, sustainability, greenhouse gas emissions impacts, community safety, the Human Rights Act, Trade Union and Council Wards can only be assessed on an individual project basis.

7.1 IMPLICATIONS FOR CORPORATE PARENTING

None

7.2 ISSUES ARISING FROM PRIVACY IMPACT ASSESMENT

None

8. NOT FOR PUBLICATION DOCUMENTS

None

9. OPTIONS

None

10. RECOMMENDATIONS

The Executive requests Council to approve the revised Capital and Investment Strategy 2020-21 with the attached Appendices and Tables.

11. APPENDICES

Appendix 1: the Council's revised Capital Strategy 2020-21.

Appendix 2: the Council's Capital Investment Strategy

12. BACKGROUND DOCUMENTS

Statutory Guidance on Local Government Investments

MHCLG Guidance on Commercial Property Investments

Appendix 1

Capital Strategy 2020/21

Updated February 2020.

(Revised) CAPITAL STRATEGY 2020/21

1 INTRODUCTION

The Council's Capital Strategy is a policy framework for the development; management and monitoring of its capital investment programme over the next financial year. It describes how planned capital expenditure, capital financing and treasury management activity will contribute to the provision of Council services during this period.

Importantly, the Capital Strategy also provides guidance on the management of any financial risk that may arise in the course of these activities and a framework for investment and capital decisions that may be taken over the next ten financial years.

The Council is required to use the Capital Strategy as the means by which it ensures compliance with mandatory statutory guidance contained in the Prudential Code for Capital Finance in Local Authorities issued in December 2017. The headline message delivered by the Code is the requirement for the Council to consider key judgement criteria of Prudence, Affordability and Sustainability when making and reviewing decisions about the use of its capital resources.

Tables supporting the Capital Strategy are set out at the end of this document.

1.1. CAPITAL EXPENDITURE

Capital expenditure is expenditure on the acquisition, creation or enhancement of assets that have a useful life of more than one year.

Table 1 provides details of the Council's assets.

1.2. GUIDING PRINCIPLES

To ensure the efficient use of all of its assets the Council will not permit any project to be included in its Capital Investment Plan (CIP) unless it furthers its strategic priorities and objectives.

Overall the following principles will apply to all capital investment decisions:

i. They should reflect the priorities identified in the Council Plan and its supporting strategies.

ii. They will be prioritised by availability of resources and allocated funding, and supported by a business case review.

iii. Priority will be given to schemes financed from capital grants or Invest to Save income streams.

iv. The cost of financing each capital scheme will be incorporated into the relevant annual policy, resources strategy and budget.

v. Commissioning and procuring for capital schemes will be legally compliant, which will be established by early and appropriate due diligence.

2 LINKS TO COUNCIL POLICIES, STRATEGIES AND OBJECTIVES

The Council's Capital Programme covers a four year period, and its existing key commitments reflect the Council Plan:

i. A Great Start and Good Schools for All Our Children
ii. Better Health, Better Lives
iii. Better Skills, More Good Jobs and a Growing Economy
iv. Decent Homes That People Can Afford To Live in
v. Safe, Clean and Active Communities
vi. A Well Run Council
vii. Leeds City Region Revolving Investment Fund

3 GOVERNANCE FRAMEWORK FOR CAPITAL DECISIONS

The Council's relevant democratic decision-making and scrutiny processes are set out in its Constitution and include:

i. A **Council Plan** which sets out strategic priorities.
ii. Approval of the **Capital Strategy, Treasury Management Strategy and Capital Programme,** including the prudential indicators referred to within them.
iii. The current **Capital Investment Plan (CIP).** Each scheme in the CIP is approved by both the Executive and Full Council. The CIP is monitored by the appropriate responsible officer, finance and the Project Appraisal Group (PAG) in order to detect and deal with any variances to the plan. Updates are reported to the Executive on a regular basis.
iv. The **Project Appraisal Group (PAG)**. Currently its membership comprises finance, legal, procurement, project management and property expertise and it is chaired by the Director of Finance.
v. A mandatory **Capital Business Case** to identify the projected running costs and financing costs of the relevant asset and assess its affordability.
vi. The Council's **Financial Regulations**. Under these regulations the PAG will assess unfunded capital expenditure proposals. Schemes funded from capital grants or Direct Revenue Financing can be progressed and approved directly. Any new capital expenditure proposals that are not wholly funded from capital grants or by the proceeds of sale of land must be either financed directly from the Revenue Estimates or be formally authorised from an identified capital scheme or approved additional borrowing.
vii. Investment assets are subject to specific approval processes, involving the Investment Advisory Group, discussed below.

4 CAPITAL RESOURCES TO SUPPORT CAPITAL EXPENDITURE

Current projects are set out in the **Capital Investment Plan 2020-21**, approved by

Council on 18th February 2020.

Invest to Save: capital financing costs are mitigated by equivalent savings or additional income in the approved revenue estimates.

Capital financing costs include the effect of previous years' capital investment, as it comes into use and provides service benefit.

5 COMMERCIAL PROPERTY INVESTMENTS

A commercial property investment strategy was approved by Executive on 4 April 2017, and permits Investments in commercial property linked to economic development and regeneration within the District, or to create long term income generation to support service delivery or a mixture of both. The Strategic Director of Corporate Services in consultation with the Portfolio Holder and Leader may make investments under the strategy.

Investments will consider factors including:-

i. Risks associated with the investment
ii. The likelihood of being able to sell the investment in extremis
iii. The location of the investment, with preference being firstly within the District and secondly within the Leeds City Region
iv. The security of direct rental payments, with consideration given to the reliability of tenants
v. The income stream from the investment, current and potential
vi. The potential increase to the capital value of the investment
vii. The sector in which the investment is made, eg retail or warehouses
viii. The detailed business case for investment

The Ministry of Housing, Communities and Local Government (MHCLG) has issued guidance on commercial property investments, and this will be considered within the Council's Investment Strategy.

6. LOANS TO EXTERNAL ORGANISATIONS

The Council may make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of strategy for local regeneration and economic growth. In such cases, a realistic assessment of potential policy gains could justify the loan even when liquidity and security considerations might indicate that it is not prudent. In such cases an expected credit loss model in line with IFRS 9 (financial instruments) would be required.

7. ASSET MANAGEMENT PLANNING

The Council Estate Management Service manages its existing assets to reduce costs

and maximise service benefit according to objectives listed in the Estates Strategy, which is due to be reviewed and updated to link to this Capital Strategy and to quantify the cost of repair and maintenance costs against the savings from extending the lives of Council buildings from 2020/21 onwards. The review will also cover disposals of buildings, which has already realised considerable savings. Receipt from such disposals may be recycled as funding for the Capital Investment Plan, and may significantly reduce the repair and maintenance on the Council's estate. Table 4 summarises the Council's recent achievements in this area.

8. PRUDENCE, AFFORDABILITY, SUSTAINABILITY

As at 31 March 2019, the Council's Capital Financing Requirement (CFR), which represents its total borrowing for capital investment, was £700 million. The CFR figure will be paid off from the Council's Capital Financing Costs in its future revenue estimates. The majority of the CFR figure involves borrowing from the Council's Public Works Loan Board Prudential Lending facility, although £169 million relates to a private finance initiative with a private company and will be repaid from future contracted lease payments.

The relationship between the CFR and other assets and liabilities is summarised in Table 6. The CFR is due to increase because of the future borrowing required to finance the 2020-24 Capital Investment Plan. The projected increase is set out in Table 2. The Capital Strategy includes measures to test the affordability of the proposed borrowing in the Capital Investment Plan (CIP), and these are set out in Table 7.

9. SKILLS AND KNOWLEDGE

The Council has professionally qualified staff across a range of disciplines including finance, legal and property. A programme of continuous professional development (CPD) is undertaken and employees attend courses on an on going basis to keep abreast of new developments and skills. The Council establishes project teams from all the professional disciplines from across the Council as and when required.

The Council uses external advisors where necessary in order to complement the knowledge its own officers hold. Some of these advisors are contracted on long term contracts or are appointed on an ad-hoc basis when necessary. The Council currently employs Link Asset Services as treasury management advisors and PWC as VAT advisors. This approach ensures the Council has access to specialist expertise when needed to support its staff, commensurate with its risk appetite.

Internal and external training is offered to members to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions taken by the Director of Finance.

CAPITAL STRATEGY TABLES

Supporting information

Table 1

Asset Balance Sheet values as at 31 March 2019

Category	**Value as at 31 March 2019 £'000**
Council Dwellings	24,620
Land & Buildings	588,574
Vehicles, Plant, Furniture & Equipment	19,448
Infrastructure	222,673
Community Assets	54,211
Surplus Assets	16,996
Assets Under Construction	32,203
Heritage Assets	37,058
Investment Property	53,592
Intangible Assets	430
Total	**1,049,805**

Source: Statement of Accounts 2018-19

Table 2

Capital Investment Plan 2020-21

	31/03/19 Actual £m	**31/03/20 Estimate £m**	**31/03/21 Estimate £m**	**31/03/22 Estimate £m**	**31/03/23 Estimate £m**	**31/03/24 Estimate £m**
Total Capital Spend	*84*	*121*	*209*	*205*	*190*	*42*
Capital Spend not funded from borrowing	*53*	*70*	*113*	*112*	*112*	*6*
Capital spend funded from borrowing	***31***	***51***	***96***	***93***	***78***	***36***

Table 3

Split of Invest to Save Borrowing

	31/03/19	**31/03/20**	**31/03/21**	**31/03/22**	**31/03/23**	**31/03/24**
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Invest to Save	**19**	**31**	**58**	**56**	**47**	**22**
Corporate Borrowing	**12**	**20**	**38**	**37**	**31**	**14**
Total borrowing	**31**	**51**	**96**	**93**	**78**	**36**

Table 4

Backlog maintenance

Backlog maintenance	**2009-10**	**2018-19**
Operational Estate £ms	83	50
Non-Operational £ms	13	8
Total Backlog maintenance £ms	**96**	**58**
Operational Estate size GIAm2 000s	319	238
Non-Operational Estate size GIAm2 000s	27	33
Total	**346**	**271**

Table 5:

Capital Financing Requirement 31 March 2019

Balance Sheet	31/03/2019 £m
Capital financing Requirement	**700**
Private finance Initiative	-169
Underlying Borrowing Requirement	**531**
Investments Held	52
Cash Reserves	-256
Less School Balances	27
Provisions/Collection Fund	-36
Borrowing from Public Works Loan Board	**318**
Under-Borrowing	213

Table 6:

Projected increased in Capital Financing Requirement

	31/03/19 Actual £m	**31/03/20 Estimate £m**	**31/03/21 Estimate £m**	**31/03/22 Estimate £m**	**31/03/23 Estimate £m**	**31/03/24 Estimate £m**
Opening Capital Financing Requirement	***669***	**700**	**731**	**802**	**867**	**914**
Increase in borrowing	*32*	51	96	93	78	36
Less MRP and other financing movements	*-1*	-20	-25	-28	-31	-34
Closing Capital Financing Requirement	***700***	**731**	**802**	**867**	**914**	**916**

Source: The Council's Capital Investment Plan 2020-21 – Council, 20 February 2020

Table 7:

Affordability measures

Measure	Current Position	Potential Position
Total Borrowing related to long term assets	As at 31-03-2019 £312m total borrowing is 30% of long terms assets of £1,050m.	CIP2020-21 has £145m of Corporate Borrowing and £219m of Invest to Save. Less £10m of general capital receipts, this assumes an increase of £354m in borrowing to £666m. Assuming this increases long term assets also by £666m to £1,716m, this is 39% of long term assets.
Total Borrowing costs as a percentage of net budget	For 2019-20 borrowing costs of £46.3m plus Invest to Save borrowing costs of £5.7m, totalling £52m are 13.8% of net budget	At 2023-24 borrowing costs of £56.2m plus invest to save of £17.5m total £73.7m. This is 19.5% of the net revenue budget.

SCHEDULE 1

THE COUNCIL'S RESPONSE TO MHCLG GUIDANCE ON COMMERCIAL PROPERTY INVESTMENTS

1. MHCLG GUIDANCE IN CONTEXT:

The Local Government Act 2003 (the Act) and supporting regulations require the Council to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, the Treasury Management Code of Practice (the Code) and MHCLG Investment Guidance (the Guidance) to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

In February 2018 the Secretary of State issued new guidance on Local Government Investments (the Guidance) which widened the definition of an investment to include all financial assets of a local authority, as well as other non-financial assets held primarily or partially to generate a profit. The wider definition includes investment property portfolios as well as loans made to wholly owned companies or associates, joint ventures or third parties. The Guidance applies to financial years commencing on or after 1 April 2018.

The Guidance requires an Investment Strategy to be approved by Full Council on an annual basis and sets out disclosure and reporting requirements. Any mid-year material changes to the strategy will also be subject to the approval of Full Council.

The Guidance sets out the government's position on borrowing in advance of need, which is 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. The Council must have regard to the Guidance, but is able to depart from it where such a departure can be justified.

The Council has noted, and has had regard to the Guidance within both its Capital and Investment Strategies. The Council has set out within the Capital Strategy its high-level approach to risk and risk mitigation, including the requirement for fully tested and scrutinised business cases, due diligence indicators and regular and formal reporting and scrutiny on investment decisions and performance.

2. BACKGROUND

Historically, the Council holds investment properties which are rented commercially. The 2018-19 Statement of Accounts show that the Council received £2.2m net income from these investments.

Table 1: Investment Property Net Income

	2018-19 £m
Rental income	-2.43
Service charges	-0.15
Repairs and Maintenance	0.23
Capital Financing costs & other	0.14
Total return	**-2.21**

The value of the Council's investment property as at 31 March 2019 was £53.6m, making a return of 4.1%. The investment property is valued higher than its purchase cost, so taking this into account, the return would be higher. This means past spend on investment property is supporting the current revenue estimates.

The Council recently invested £4.4m in an NCP car park in the district, which in 2018-19 generated gross rental income of £0.33m; and a net rental income of £0.15m over the capital financing costs. The Council aims to develop a sustainable funding model for the revenue estimates as general government grants reduce. As part of this, a £40m budget over four years for property investment is included in the 2019-20 Capital Investment Plan.

Investment property is included in the Council's balance sheet on a fair value basis. It is the Council's view that in the medium term, investment assets will retain sufficient value to provide security of investment using the fair value model set out in *International Accounting Standard 40: Investment Property*. A fair value assessment has been made on Investment Properties for the 2018/19 audited accounts, and underlying assets provide security for capital investment.

The Ministry of Housing, Communities and Local Government Guidance on Local Government Investments states: "Where a local authority is or plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the service delivery objectives and place making role of that local authority is dependent on achieving the expected net profit".

Based on the indicators set out below, it is the Council's view that dependence on investment activity is currently low. Income from commercial property investment budgeted is estimated to potentially climb to £4m. This represents 1.7% of the Council's net service expenditure.

3. GOVERNANCE ARRANGEMENTS

The Council will continue to invest prudently on a commercial basis, supported by a robust governance process.

The 2018-19 Capital Strategy set out the assessment criteria, when considering a new purchase to ensure Prudence, Sustainability and Affordability. It is proposed to retain these criteria shown below, subject to minor adjustments (in italics):

<u>Non Financial Investment Criteria:</u>

i. Risks associated with the investment

ii. The likelihood of being able to sell the investment in extremis

iii. Whether the location is attractive for selling or letting and whether the location is easy to travel to so that it can be inspected without specialist agents

iv. The preference for the location of the investment to be firstly in the district and secondly in the Leeds City Region

v. The security of rental payments, with consideration given to the reliability of tenants

vi. The prospective length of any lease period for which rental payments are

received

vii. The income stream from the investment, in proportion to its capital financing costs and budgeted rentals in the revenue estimates

viii. The potential to increase both the income stream and the capital value of the investment

ix. The likelihood of the capital value of the investment exceeding any outstanding debt

x. The value of the investment

xi. Management costs

xii. The sector in which the investment is made, for example, retail or warehouses.

xiii. Any prospective tenants or partners in the investment must not be involved in commercial activities that conflict with the Council's values.

The Council has set up a Project Appraisal Group to consider business cases in relation to Capital Investment Proposals.

The Investment Business Case will identify the projected yield, running costs and financing costs of the proposed investment. The proposed scheme will be scored against criteria based on the investment criteria outlined above, and the performance indicators set out later in this report.

Capacity, Skills and Use of External Advisors

The guidance requires that elected members and officers involved in the investment decision making process have appropriate capacity, skills and information to enable then to take informed decision as the whether or not to enter into a specific investment. The Council recognises that investing in land and properties to generate yield and capital returns is a specialist and potentially complex area. JLL have been appointed as the Councils advisors in relation to investment property, and will be assisting in the development and delivery of the investment strategy. In addition, the Council will procure specialist legal and financial advisors where necessary. This will ensure that the Council has access to requisite specialist skills and resource's to inform the decision making process.

The Council requires advisors negating deals on behalf of the Council to be aware of the core principles of the prudential framework and the regulatory regime in which the Council operates.

4. Prudential indicators

MHCLG Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of commercial property investment decisions.

The indicators associated with the Council's proposed commercial property investment strategy are detailed within the Annex to the Investment Strategy that is set out in Schedule 2 of the Capital Strategy. Further indicators may be developed by the Investment Advisory Group.

5. RISK MANAGEMENT

5.1 Financing and Liquidity Risk

As with all investments, there are risks that capital and rental values can fall and rise. To mitigate against future unfavourable market forces, commercial property investment acquisition's will be made on the basis that the Council will and is capable of holding property investments for the long term, i.e. 25 years +. This will ensure that income and capital returns are considered over the long term thereby smoothing out any cyclical economic effects.

The fair value assessment of assets and prudential indicators set out above provide assurance that there will be minimal short term liquidity risk, i.e. a need to sell assets in order to repay capital borrowed. In the medium longer term, as borrowing is repaid via MRP, the liquidity risk is reduced as the borrowing associated with the asset decreases.

5.2 Portfolios risk – void periods

To mitigate the risk of void periods where the property is either partially or fully vacant, or a tenant has defaulted on its obligations, the investment portfolio will be actively managed in accordance with existing asset management procedures.

The investment criteria specified above:

> "Whether the location is attractive for selling or letting and whether the location is easy to travel to so that it can be inspected without specialist agents"

should favour secure property investments, i.e. high quality buildings in prime locations, mitigating the risk of void periods on re-letting.

Appendix 2 to the Executive Report

Schedule 2 of the Capital Strategy

Investment Strategy 2020/21

Updated February 2020.

Schedule 2

INVESTMENT STRATEGY

1. BACKGROUND:

This strategy document sets out the Council's annual Investment Strategy as is required by the 3rd Edition of the Section 15 guidance on local government finance issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003 in 2018. It covers the budget year 2020/21 onwards.

The overall objective of the strategy is to provide high-level guidance on acquiring and managing investments in order to improve the financial resilience of the Council, the income base for its services and to ensure that its financial assets are applied efficiently for the benefit, improvement or development of the area through the acquisition, retention and management of good quality investments and the granting of loans.

The Investment Strategy supports the Council's Economic Strategy in order to deliver economic growth, tackle inequality and create change in the area that benefits everyone. It will guide the Council in establishing and managing a balanced portfolio of investments in order to appropriately spread risk. The Council will regularly develop and modify the Investment Strategy in response to specific investment decisions, and will formulate more detailed and nuanced indicators as it gains practical experience of how each indicator can contribute to the overall investment management process.

2. INVESTMENTS – SUMMARY

For the purposes of this Strategy an investment includes all of the Council's financial assets as well as any other non-financial assets that it holds primarily or partially to generate a profit; for example, investment portfolios.

The definition of an investment also covers loans made by the Council to one of its wholly-owned companies, or to a joint venture, or to a third party. Such investments are most likely to be made in order to achieve its policy aims for local economic growth, and their yield will require assessment by reference to their contribution in financial and non-financial terms.

The investment strategy does not include investments that are managed as part of the Council's normal treasury management processes or any delegations from that process.

3. KEY STRATEGIC PRINCIPLES

The Council's Investment Strategy will focus upon establishing objective criteria for investment by reference to:

i. Transparency and democratic accountability

ii. Contribution

iii. Use of indicators

iv. Security, Liquidity and Yield

v. Investment Limit

It recognizes that an effective strategy requires a degree of flexibility in its implementation and that, from time to time, investment opportunities may arise that do not precisely meet its financial criteria but which nevertheless present the possibility of potential returns in terms of achieving strategic or policy aims. In order to enable the Council to deal with such opportunities on a consistent and objective basis it will implement Risk Assessment arrangements through business case evaluation by its Project Appraisal Group, as is currently provided for under the capital expenditure arrangements set out in Rule 16 of its Financial Regulations.

3.1 Transparency and democratic accountability:

The Council is required to prepare at least one annual Investment Strategy that contains the details specified in the 2018 guidance. This Strategy has to be approved by the full Council, and will be annually reviewed prior to the start of the financial year. In the event of a material change then a revised Strategy will be presented for approval before the proposed change is implemented.

3.2 Contribution:

Investments made by local authorities can be classified into on of two main categories

1. Investments held for treasury management purposes; and
2. Other Investments

The former are reported in the Treasury Management Strategy an associated report and are not therefore repeated within this Investment Strategy, which only applies to “Other Investments”.

The Council’s Other Investments are required to be applied efficiently for the benefit, improvement or development of the area. This may occur by the investment facilitating the efficient use of the Council’s financial resources, by contributing to its future resources or by enabling it to achieve its policy and strategic aims. In each case the concept of *Contribution*, in the sense of asking whether the investment will make a positive difference will be a key determinant in decision-making. The assessment of contribution will be made within the entire investment framework, and will include the acquisition, retention and management of investments and the granting of loans.

The Council recognizes that investments can make different types of contribution, and each investment can have more than one type of contribution. A non-exhaustive list of potential types of contribution include:

i. Yield/profit
ii. Regeneration
iii. Economic benefit/business rates growth

iv. Responding to local market failure
v. Treasury management
vi. Invest to Save Schemes capacity to reduce costs or generate additional income from an asset.

Where an investment is classified as contributing to regeneration or local economic benefit, the supporting business case assessment should demonstrate that the investment forms part of a project in the Council's Local Plan or some other formal statement of the Council's strategic or policy aims.

3.3 Investment indicators:

The Council proposes to adopt a system of quantitative indicators to guide and inform investment decisions relating to Other Investments. The Council proposes to initially adopt the indicators proposed within the Guidance (see the Annex to this Investment Strategy). These indicators will be reported upon and reviewed annually.

The Council's proposed range of indicators will allow members and other interested parties to understand the total exposure from borrowing and investment decisions. They will cover both the Council's current position and the expected position assuming all planned investments for the following year are completed. They will not take account of Treasury Management investments which will continue to be reported within the Treasury Management report.

3.4 Security, Liquidity and Yield:

In this context, Security means protecting the capital sum invested from loss; and Liquidity means ensuring the funds invested are available for expenditure when needed. Yield is the expected return of the investment over its lifetime, and can be expressed either in financial terms or as the achievement of policy or strategic aims.

In considering Other Investments the balance between security, liquidity and yield will be considered as part of the business case, alongside the contribution the Other Investment can make to achieving policy objectives.

3.5 Investment Limit

The Council will from time to time set one or more Investment Limits and keep them under review. The Council will use prudential borrowing to fund Other Investments / strategic acquisitions. Currently interest rates remain at a low level and the rental income / Contribution from Other Investments should more than cover the associated debt costs, whilst also providing a net yield to support the Council's revenue budget. The Council has the ability to fix interest over the long-term which removes the risk of interest rate volatility.

Provision of £40 million has been included in the capital programme, phased across the programme and funded by prudential borrowing.

There may be a need for the Council to be able to respond quickly as an investment

opportunity arises and therefore clear and agile governance structures and processes have been put in place. These are supported by detailed business case appraisals.

4. GOVERNANCE ARRANGEMENTS

The Council has set up an Investment Advisory Board to consider specific business cases in relation to investing in Other Investments / strategic acquisitions. The core group consists of:-

- Leader of the Council – (Chair)
- Cllr Alex Ross Shaw – portfolio holder for Regeneration, Planning & Transportation
- Cllr John Pennington – leader of the Conservatives
- Cllr Jeanette Sunderland – Leader of Liberal Democrat & Independent Group
- Strategic Director of Corporate Resources
- Strategic Director of Place
- Director of Finance / s151 Officer
- Assistant Director Estates & Property
- City solicitor / Monitoring Officer

Other officers will attend as relevant to the specific business case.

5. RISK ASSESSMENT

The Council will regularly review its approach to assessing risk of loss, and such an assessment will be undertaken before acquiring any investment, whether held for treasury management or other investment purposes, and whether the investment is financial or non-financial. The Council proposes to formulate and then adopt a formal risk assessment system for this purpose and this will include consideration of the Council's current risk appetite and both its Capital and Investment Strategies. Such assessments will continue to be made during the period that each investment is held. The risk assessment structure will consider the following factors:

i. In relation to all investments, how it has assessed the market that it is/will be competing in, the nature and level of competition, how it thinks that the market/customer needs will evolve over time, any barriers to entry and exit and any on-going investment and regulatory requirements.

ii. Whether, and if so, on what terms the Council uses external advisors as treasury management advisors, property investment advisors or any other relevant persons. In each case such engagements will be on the Council's standard terms and conditions unless there is an agreed exception, as is provided for under No. 17 of the Council's Contracts Standing Orders.

iii. The outcome of any monitoring by the Council of the quality of advice provided by its external advisors.

iv. To what extent, if at all, any risk assessment is based on credit ratings issued by credit ratings agencies, and the reliability of such ratings given the current degree of engagement between the rating agency and the market under assessment.

v. Where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change.

vi. What other sources of information are used to assess and monitor risk.

vii. Any specific property-related risks – covenant strength, lease period/s, condition, maintenance costs, etc.

Risk Assessment will be undertaken as part of business case considerations and regularly reviewed.

6. CAPACITY, SKILLS AND CULTURE

The guidance requires that elected members and officers involved in the investment decision making process have appropriate capacity, skills and information to enable then to take informed decision as the whether or not to enter into a specific investment. The Council recognises that investing in land and properties to generate yield and capital returns is a specialist and potentially complex area (see Schedule 1 to the Capital Strategy dealing with the Council's response to MHCLG guidance on commercial property investments). JLL have been appointed as the Councils advisors in relation to investment property, and will be assisting in the development and delivery of the investment strategy. In addition, the Council will procure specialist legal and financial advisors where necessary. This will ensure that the Council has access to requisite specialist skills and resource's to inform the decision making process.

The Council requires advisors negating deals on behalf of the Council to be aware of the core principles of the prudential framework and the regulatory regime in which the Council operates.

Annex to Capital Strategy:

Selected Investment Indicators

The guidance specifies certain indicators which the Council has adopted as below.

These indicators are based on a number of assumed factors (e.g potential future investments and the timing of these), as such the indicators will be impacted by changes to these factors. However, they are an initial benchmark upon which investments can be monitored and reported upon.

It is expected that the selected indicators will be reviewed as the Investment Strategy evolves.

Debt to Net Service Expenditure (NSE) Ratio

This indicator measures the gross debt associated with property investment as a percentage of the Council's net service expenditure, where net service expenditure is a proxy for the size and financial strength of a council.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Gross Debt	24,731	34,329	43,652
Net Service Expenditure	378,080	378,080	378,080
Debt to NSE Ratio	6.5%	9.1%	11.5%

The indicator shows that the proposed debt level will be approximately 11.8% of the Council's net revenue budget if the proposed £40m investment in commercial property (and related investment) is funded solely from borrowing.

Investment in commercial property will asses the risk profile as part of the decision making process, and any such investment will be long term. Therefore this ratio is considered reasonable.

A maximum limit of 30% has been set for this ratio.

Commercial Income to NSE Ratio

This indicator measures the Council's dependence on the income from all property investments to deliver core functions.

The income generated from property investments will fund 1.4% of the Council's' net service expenditure over the medium term. This ratio is considered reasonable.

A maximum limit of 5% has been set for this indictor, to be reviewed upon completion of the £40m additional investment approved for purchases.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Commercial Income	4,033	4,733	5,432
Net Service Expenditure	378,080	378,080	378,080
Commercial Income to NSE Ratio	1.07%	1.25%	1.44%

Investment Cover Ratio

This indicator measures the total net income from property investments compared to interest expense.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Investment Cover Ratio	1.02	0.64	0.45

The indicator shows that net income from property investments is expected to be 0.45 times higher than the anticipated interest expense on average over the three years of the strategy.

Loan to Value Ratio

This indicator measure the amount of debt compared to the total asset value. In the period immediately after purchase it is normal for the directly attributable costs of purchasing commercial property investments to be greater than the realisable value of the asset (for example, because of non value-adding costs such as stamp duty and fees). The loan to value ratio should gradually decrease, reflecting the assumption that property values will remain constant while borrowings will be repaid.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Loan to Value Ratio	1.01	0.99	0.97

Target Income Returns

This indicator for new investments shows net revenue income compared to equity and is a measure of the achievement of the property portfolio.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000

Target Income Returns	3.06%	2.25%	1.72%

Gross and Net Income

The net income targets (for all commercial income) are included in the Council's financial projections. The achievement of target income streams will be managed as part of the Council's standard budget monitoring process. Targets are dependent upon investments being made.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Gross Income	4,052	4,779	5,517
Net Income	2,498	2,513	2,492

Operating Costs

Operating costs relate to the cost of the Council's internal Estate Management function in relation to managing assets acquired under the property investment strategy.

Additional operating costs may be incurred as a result of the purchase of investment properties. Any such costs will be factored into financial appraisals as part of the purchase assessment to ensure that target net rates of return are achieved. This indictor may therefore require revision after investments are made.

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Operating Costs	510	510	510

Vacancy Levels and Tenant Exposures

	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Void percentage	<10%	<10%	<10%

This metric reflects the strong tenant covenant strengths that will be required due to the application of the commercial property investment factors set out in the Capital Strategy. Void periods will be factored into financial appraisals as part of the assessment criteria where relevant, therefore this indicator may be revised once investments have been made.

Additional Indicators

Additional indicators may be utilised to provide assurance regarding other investments. This may include the percentage of other investments as a proportion of the total Capital Investment Programme.