

City of York Council Capital Financing and Investment Strategy 2021/22

Introduction and Summary

The capital financing and investment strategy forms a key part of the council's overall financial planning framework and provides a mechanism by which capital expenditure and investment decisions are aligned over the term of the medium term financial strategy. It also provides a framework by which major investment decisions will be made and sets a framework for all aspects of the council's capital and investment expenditure including prioritisation, planning, funding and monitoring. It is linked to, and should be read in conjunction with, the medium term financial strategy (MTFS), annual revenue and capital budget reports and treasury management strategy statement (TMSS).

Impact of COVID-19

At the time of writing (January 2021) the UK is still dealing with the impact of the Coronavirus pandemic. The longer term impact of what has been a global pandemic on the economy, and therefore the Council's longer term capital strategy, is still unclear. The combination of uncertain markets along with the need to accelerate the city's economic recovery means that particular care is needed when making significant financial decisions. In light of this, the Council has reviewed the Capital Programme and whilst the transformational projects to drive regeneration and accelerate the city's economic recovery will continue at pace, this will be alongside continued consideration of the risk associated with any capital investment. There should be strict adherence to the Council's project management framework which has processes in place to effectively manage risk.

Objectives

This strategy will:

- Provide a framework for investment decisions
- Outline how we prioritise investment and capital decisions
- Identify how we will use our resources effectively and efficiently to deliver the council plan
- Set out how the council identifies and prioritises funding requirements
- Set out the council appetite for risk
- Consider how resources can be maximised to generate investment
- Ensure there is an overall balance of risk and rate of return
- Stress the importance of carrying out robust sensitivity analysis and due diligence
- Ensure effective arrangements for the management of expenditure including the requirement to carry out an assessment of outcomes and deliverability whilst ensuring value for money is achieved
- Reinforce the overriding requirement for security, liquidity and yield on all council investments
- Ensure that all decisions take into consideration climate change, carbon reduction and sustainability issues

Risk appetite

With regard to investments and commercial activity the council acknowledges that risk will always exist and will take some measure of risk in order realise investment gain. The council will balance risk and return in order to achieve our objectives and priorities, as set out in the Council Plan. Through robust due diligence any decision made will consider risks and mitigation to ensure full understanding of the risk associated with each investment. The council will seek to

minimise exposure to risks that are not rewarded with additional income. Capital is managed corporately on an ongoing basis to ensure that there is sufficient liquidity in the short and medium term to meet expenditure incurred. The council is exposed to numerous risks including:

- Financial related to investment, cash flow, market volatility, etc.
- macroeconomic related to growth or decline of the national economy
- Counter party related to investments with institutions
- Operational
- Strategic
- Reputational
- Governance

Our risk appetite is supported by:

- Risk management strategy and framework
- Code of corporate governance
- Regular reporting of risk

Key areas where risk is considered further include:

- Capital programme
- Medium term financial strategy
- Performance management
- Treasury management
- Council owned subsidiaries
- Internal and external audit

Governance

All new programmes will be appraised using all about projects framework. A strategic business case will be prepared and will include any investment required, sources of funding, outcomes to be delivered, risk assessments, due diligence, repayment mechanisms, revenue impact and full lifetime costings. The proposal must also include details of any impact on revenue and in particular the delivery of previously agreed budget savings. If the strategic business case is approved, these estimates will be further refined and verified in an outline business case and ultimately a full business case.

All schemes being considered should, wherever possible, look for external funding and have explored if there is a suitable partnership approach to draw in other sources of funding to maximise the benefit to the tax payer and work with partners to secure the best possible outcomes for residents.

The council priorities are set out in the Council Plan. All expenditure proposals should identify how they will help to achieve these objectives.

A robust, formal due diligence process must be followed and details included in the full business case. This should include, as a minimum, consideration of the following:

- An assessment of the risks in the short and long term and how these risks can be mitigated
- Sensitivity analysis over the short and long term
- An impact assessment of the expenditure or investment being considered
- An overview of the evidence on which the proposal is based (eg evidence of demand, etc.)

The council will undertake regular monitoring of all investments and any issues will be included in the finance and performance monitoring reports to Executive. If an investment is underperforming, appropriate action will be taken to ensure the investment is not held longer than necessary.

The annual strategy will be approved by Executive and Full Council as part of the annual budget setting process. Any changes or updates will be reported in a mid-year review.

Quarterly capital monitoring reports will continue to be considered by Executive and will reflect any changes in resource allocation, rescheduling of delivery (slippage) and any new programmes of work agreed. These reports will also monitor delivery of capital receipts and overall funding of the programme.

Capital and Investment Priorities

Capital expenditure must be affordable, prudent and sustainable. New expenditure proposals must be balanced against the need to maintain the potential and economic benefit of existing assets. Asset management plans need to reflect the costs of maintaining the existing asset base and not simply focus on acquiring new assets for investment purposes. The annual capital budget report identifies the 5 year planned programme of expenditure and how this is funded. Regular reports are presented to Executive to monitor progress, agree slippage and any other reprofiling of spend and approve any transfer of resources between service areas.

The council will continue to seek and deliver projects that generate longer term economic growth alongside the financial benefits. In order to maximise the financial benefits of the business rate retention scheme, the impact of business rates should be considered as a key factor in the assessment and prioritisation of capital investment.

Capital Funding

The capital programme is funded from a range of different sources including:

- Prudential borrowing – the introduction of the Prudential Code in 2004 allowed the council to take on unsupported borrowing. This borrowing is subject to the requirements of the Prudential Code which means the council must ensure this borrowing is affordable and prudent.
- External Grants – this includes disabled facilities grants and various government grants for highways repair
- Section 106 and external contributions – some schemes in the capital programme are funded by contributions from private sector developers and partners.
- Revenue funding – revenue resources can be used to fund capital schemes
- Capital receipts – receipts arise from the sale of surplus assets.

Further details are included in the annual capital budget report.

Debt, borrowing and treasury management

The council produces a separate treasury management strategy statement, which is approved by Full Council as part of the annual budget setting process.

Pension fund guarantees

The council has entered in to a number of long term contracts for services that have involved the transfer of council staff to a new service provider. Employee's rights are protected under the provision in the Transfer of Undertakings (Protection of Employment) Regulations 2006, commonly referred to as TUPE. As a result, the council has given subsumption pension guarantees to a number of organisations.

Knowledge and Skills

The capital financing and investment strategy and the treasury management strategy are managed by a team of professionally qualified staff, with extensive local government experience. They all attend courses on a regular basis to keep abreast of new developments.

Internal training is offered to members of the Audit & Governance committee on an annual basis to ensure they have the necessary knowledge and understanding.

Where the council does have the knowledge and / or skills required use is made of external advisers that are specialists in their field. The council currently employs the Link Group as treasury management advisers.

Asset Management Strategy

The council has a range of property assets held for the following reasons:

- Operational – supporting core business and service delivery
- Investment – to provide a financial return to the council
- Regeneration / Commercial – enabling strategic place shaping and economic growth

In September 2017 the council agreed a refreshed and updated asset management strategy covering the period 2017 to 2022. This sets out how we will use our assets to deliver policy goals, operate our estate efficiently and generate maximum income to support delivery of council services.

Property Investment

The way the council funds the purchase of property will be determined on a case by case basis, depending on the overall economic conditions and depending on other capital expenditure being incurred. If the purchase is funded by borrowing, then the rental income generated must exceed the cost of repaying the borrowing each year. Any surplus will be used to support the council's overall budget position, enabling the council to continue to provide essential services for residents. Our investments in commercial property to date have been relatively modest in the context of percentage of total budget but any future proposals to invest in property will need to be mindful of the extent to which they increase the percentage of our total income invested in this area.

The reasons for buying and owning property are (in order of importance):

1. Economic development and regeneration in York
2. To generate income in order to provide services for local people
3. Opportunity

Property price and return on investment will depend on the type, location and current condition of the asset as well as the strength of the lease / covenant arrangements of the current tenant. The council will only purchase property within its boundary. The council should seek the best returns available, whilst carrying an acceptable level of risk. The rate of return must be better than the returns available from alternative, more secure investments (eg money market funds). The annual return must also exceed the cost of PWLB borrowing.

The council will take a balanced approach in order to minimise risk. This will include ensuring not all investment income is derived from one asset category or only one type of investment, such as commercial property. In future the council will consider whether a limit should be set on the amount invested in any one area to ensure it is not vulnerable to sudden changes in market conditions. When considering rate of return, a review will be carried out so that the value of investments is also considered over the life of the asset rather than focussing on short term returns only. Future reviews of this strategy will also include issues such as when to exit underperforming investments.

The asset management strategy:

- sets out what the council seeks to achieve when purchasing any property
- identifies any possible risks
- clarifies the legal powers used to acquire any property
- identifies the criteria for acquiring and owning assets
- outlines the process for acquiring assets

At 1st April 2020 income from property assets, excluding operational assets was c £6.0 million, which represents a return of 6.4%. This excludes properties which are used solely or partially as operational assets, residential assets, assets which are leased in and any assets which are held for development and minor agreements.

Property disposal and capital receipts

The asset management strategy will continue to identify surplus or under used property. Surplus properties will be used to generate revenue where possible or will be disposed of to generate a capital receipt. Capital receipts are corporate resources and will be used to support the councils key aims and priorities rather than being allocated to specific schemes. This could include repayment of existing debt, mitigating future requirements to borrow and financing transitional costs of change. Any decisions will be taken by Executive in line with the constitution.

Climate change, carbon reduction and sustainability

Along with many other organisations across the country, the council has declared a climate emergency and set a target to become net carbon neutral by 2030.

In addition, the council continues to be committed to achieving our ambition to be a more sustainable, resilient and collaborative organisation. With a challenging financial climate and increasing demand for our services, our aspirations to be a Greener and Cleaner city are an essential part of making the most of the resources we have and helping us to prepare for the future. Our Council Plan commits us to putting climate change and sustainability at the heart of everything we do, delivering a sustainable environment and addressing the climate emergency

Capital investment will therefore need to demonstrate that it meets these aims of the Council Plan and energy efficiency implications should be considered in the assessment of proposed schemes, along with potential savings being identified. The council will also consider suitable cost saving opportunities in relation to energy efficiency and sustainability. The development of a climate change plan is ongoing and any implications of this will be incorporated into future versions of this strategy.

Housing Revenue Account (HRA)

The (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately within the accounts. The abolition of the HRA Debt Cap on 29th October 2018 represented a significant change in the council's ability to resource new council housing, major

repairs and improvements to the existing housing stock and regeneration. A report on proposals for New Council Building in January 2019 recommended investment of £153.9m in building over 600 new houses of which 250 would be classed as affordable. This investment will be funded through a combination of utilising additional debt headroom to fund the appropriation of land from the general fund, proceeds from market sales and equity sales of shared ownership units alongside HRA resources such as Right to Buy Receipts and investment reserve. Executive receive regular updates and approve individual site investments when required. In addition the HRA continues to significantly invest in the structural maintenance of existing stock within its capital programme. Investment over the period 2021/22 to 2025/26 in this area totals c £45m.

The 30 year HRA Business Plan financial forecast sets out the financial implications of delivering the overall plan and providing assurance that the HRA will remain financially viable. The forecast shows that debt will increase to £156m following the appropriation of general fund sites for development and this will be fully repaid by the end of the period. This demonstrates the financial strength of the HRA business plan. The HRA business plan is a key part of the council's long term financial planning, and sets out how we will deliver and finance services to tenants, and investment in their homes, over a 30-year period.