

Item

## CAPITAL STRATEGY 2019/20 TO 2027/28



**To:**

Councillor Richard Robertson, Executive Councillor for Finance and Resources

Strategy & Resources Scrutiny Committee 11/02/2019

**Report by:**

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**Wards affected:**

All

### Not a Key Decision

#### 1. Executive Summary

- 1.1 The Council continues to develop and expand well-established, long-term capital planning.
- 1.2 This report outlines the capital strategy of the Council together with a summary capital programme for the General Fund (GF) and the Housing Revenue Account (HRA). The previous capital strategy was approved by Council on 22 February 2018 and this update has been focused on providing a framework for delivery of the capital expenditure plans over a 10 – 30 year period. Governance arrangements are also outlined in order to ensure the capital programme continues to deliver value for money.
- 1.3 The Council has a substantial Capital programme which is mainly guided by and supports the strategic aims of the Council as outlined in the *One Cambridge – Fair for All* vision and defined in the *Annual Statement* as published on the Council website.
- 1.4 There are 7 primary aims in the *Annual Statement*

- *Delivering sustainable prosperity for Cambridge and a fair share for all*
- *Tackling the City's housing crisis and bold strategic planning for Cambridge*
- *Making Cambridge safer and more inclusive*
- *Investing in improved transport and tackling pollution and congestion*
- *Protecting our City's unique quality of life*
- *Protecting essential services and transforming Council delivery*
- *Tackling climate change and making Cambridge cleaner and greener*

1.5 Major projects and external influences have a bearing on the successful delivery of these aims.

### ***Local Plan***

1.6 The Cambridge Local Plan was adopted in October 2018 which will guide development in the City in coming years, with 14,000 additional homes and 22,000 additional jobs set to be created by 2031.

1.7 Among the areas designated in the plan for potential future development is the Cambridge Northern Fringe East (CNFE) area around Cambridge North Station. The Council is working with partners to secure c£227 million in national funding to support the relocation of Anglian Water's Cambridge Water Recycling Centre. If this bid is successful 5,200 homes are planned for the core site, together with around 1m square feet of commercial space (7,000 jobs) and a mix of retail, community and leisure space. The redevelopment of the adjacent sites covering the wider CNFE area, if enabled by the relocation of the water recycling centre, has the potential to deliver an additional estimated 2,400 homes and around 40,000 new jobs, supported by amenities and community facilities. As a significant land owner in the area the project to develop CNFE has implications in terms of capital expenditure and as a source of funding in the form of capital or other receipts.

### ***Delivery of new Council Homes***

- 1.8 £70m of devolution grant has been secured towards the provision of 500 new council houses in Cambridge. This funding is to be used alongside right to buy receipts from the sale of Council dwellings.
- 1.9 The Council has formed a number of 50:50 joint venture partnerships with Hill Residential under the umbrella of the Cambridge Investment Partnership (CIP). CIP is already undertaking a redevelopment of the Council's former depot at Mill Road which will provide an equal number of market and council homes.
- 1.10 A former builders merchant's site at Cromwell Road was purchased in summer 2018 which is currently planned to be redeveloped with CIP to provide 295 units, 40% of which will be new council homes.
- 1.11 Other opportunities with CIP including the possible redevelopment of existing community centres to re-provide the existing use alongside new council homes.

### ***Other capital priorities***

- 1.12 In addition to the major plans above for the delivery of new homes and businesses in Cambridge, the Council also has plans for a number of enabling investments to drive digital delivery and service improvement. This includes investment in new IT equipment to promote flexible and collaborative working under the umbrella of 'Council Anywhere' and the replacement of a number of key systems including the housing management system.
- 1.13 The Council also uses condition surveys and asset management planning for both the Housing Revenue Account and the General Fund to inform priorities for capital expenditure.
- 1.14 The Council has worked closely with the Cambridgeshire and Peterborough Combined Authority on the project to develop CNFE, which was prioritised by the Combined Authority as its only submission in the current round of funding bids for the Housing Infrastructure Fund.
- 1.15 The Combined Authority is also responsible for the allocation of the 500 council homes grant to the City Council.

## ***Section 151 Officer Summary***

- 1.16 The Council's Section 151 Officer is required to report explicitly on the affordability and risk associated with the Capital Strategy
- 1.17 As highlighted in this report the Council ensures that capital projects and schemes are accompanied by detailed funding proposals. Where projects are to be funded from borrowing – either internally from cash balances or externally, a prudent Minimum Revenue Provision charge is made. The Council has not borrowed externally to fund capital expenditure in the recent past, the current external borrowing representing debt incurred on the transition from the old housing subsidy system to HRA self-financing.
- 1.18 Where the Council has expanded its commercial activities by purchasing additional commercial properties or making loans to subsidiaries and joint ventures to facilitate the provision of intermediate housing or the development of sites for market and affordable housing it ensures that the risks taken are proportionate to the size and scale of the authority. Legal advice is taken alongside the completion of appropriate due diligence and any loans are secured where appropriate. On projects undertaken by Joint Ventures the Council monitors the expected repayment of loans and expected future surpluses carefully. The Council has not borrowed externally to fund the increase in commercial activity and if future external funding becomes necessary appropriate external advice will be sought as necessary.

## **2. Recommendations**

The Executive Councillor is recommended to:

- 2.1 Approve the capital strategy as set out in this report.
- 2.2 Note the summary Capital programme.

### **3. Background**

3.1 The capital strategy has been evolving, in line with guidance, in recent years and is now acknowledged as a prime policy document which specifically focuses on the key areas of :

- Capital expenditure
- Debt, borrowing and treasury management
- Commercial activity

3.2 A review of knowledge and skills has been carried out in light of this strategy and is shown in appendix 3 for information.

### **3.3 Capital expenditure**

- The Council manages the majority of services in house and has an operational asset base to support these services - including community centres, car parks, a crematorium and vehicle fleet. This asset base must be maintained and assets replaced or upgraded as they age. This often reflects an enhancement e.g. providing better energy efficiency.
- Expenditure also includes purchase or development of new assets, for example community centres in new areas of the city or purchase / improve new investment properties to generate additional income to support council services.
- Grants, loans or investments made by the Council are treated as capital expenditure.

#### ***Approval of Capital Expenditure***

3.4 One of the key principles of the process for the approval of capital expenditure is to ensure that when Council considers which capital projects to fund at the at Mid-Term Financial Strategy (MTFS) or Budget Setting Report (BSR), those projects have been properly

planned and developed and appropriate risks considered and are therefore ready to be implemented, subject to procurement regulations.

- 3.5 Plans for capital expenditure must also be linked to the Council's vision and address other strategic considerations, including impact on the climate.
- 3.6 The Council is developing an enhanced process for the review of capital projects prior to approval by Members. These arrangements are being coordinated by the Council's Corporate Programme Office (CPO). The objectives include ensuring that the Council has the capacity to deliver on projects which are approved for inclusion on the capital plan. Review of capital proposals should also ensure that the sensitivity of costs to both external and external risks is considered.
- 3.7 Under this process one of the Business Transformation, Place, Digital and Corporate Transformation Boards will review and approve proposals prior to any political approval that is required and funding approval in the BSR or MTFs. The CPO and a virtual Quality Assurance Group (QAG) will review projects prior to presentation to the relevant board.
- 3.8 The process gives the boards responsibility for monitoring the delivery of projects and ensures 'lessons learned' reviews take place which identify both good practice and weaker areas. These reviews are shared and help to inform decision making on future projects and schemes.
- 3.9 Where projects are to be funded by S106 contributions they are allocated S106 funding by the appropriate area committee or Executive Councillor via the S106 priority-setting process.
- 3.10 The HRA capital programme is scrutinised by the Housing Management Team and the Housing Committee prior to decisions being taken as part of the Housing BSR and MTFs.

## ***Financing of capital expenditure***

- 3.11 Consideration of the financing of capital projects is integral to the governance procedures outlined above.
- 3.12 In general the Council finances capital expenditure from existing resources including reserves and capital receipts or from specific grant funding. This ensures that capital expenditure is both affordable and prudent.
- 3.13 Revenue contributions to capital are an important source of funding for both the General Fund and the Housing Revenue Account.
- 3.14 Work with Heads of Service on forecasting possible General Fund capital expenditure requirements over the next 10 years has identified a core of around £2.0m per annum of expenditure to update or replace assets reaching the end of their useful lives. This sort of expenditure would normally be funded from revenue resource.
- 3.15 In the HRA the Council is required to make a contribution from revenue resources to the Major Repairs Reserve each year – this is equal to the assessed depreciation on HRA assets. This funding is predominantly used to maintain existing Dwellings to decent homes standards and on supporting the build of new homes. The HRA also uses direct revenue funding from its resources to support re-provision of existing units (which cannot be funded from right to buy receipts) and wider investment on housing estates.
- 3.16 Where the Council identifies that capital expenditure is to be financed from borrowing, either externally or internally, a Minimum Revenue Provision (MRP) charge is made to revenue to fund the repayment of the debt. There will be circumstances in which MRP is not required and these are outlined in the Treasury Management Strategy.

## ***Asset Management Planning***

- 3.17 The Council regularly reviews the condition of its existing assets, using specialist advisors where appropriate.
- 3.18 This includes reviews of the maintenance requirements of operational property, investment properties and council housing stock. As detailed in Section 7 the Council is undertaking a Property Portfolio Review. As well as considering the maintenance requirements of the Council's Investment Properties it will also consider the wider property estate. This will report in 2019 and a summary included in the Capital Strategy. The Asset Management Plan for housing stock is also being updated.
- 3.19 With the exception of the £214m loans taken out on the inception of self-financing of the Housing Revenue Account at the end of the previous subsidy system, the Council currently has no external debt. It therefore does not need to consider the impact of past borrowing on asset management plans.
- 3.20 The maintenance costs of existing assets are considered carefully alongside replacement or upgrade decisions. For example the Council has its own fleet garage located in Waterbeach which is responsible for the maintenance of vehicles and keeps detailed records against each asset. Annual budgets include provision for the maintenance of assets and service managers have the opportunity to make bids and offer savings in maintenance funding as part of the annual budget-setting round.
- 3.21 Debt, Borrowing and Treasury Management.**
- 3.22 The Council has both external borrowing with the Public Works Loan Board (PWLB) and 'internal' borrowing from cash balances. This borrowing is managed alongside the investment of cash balances as part of the Council's Treasury Management Function.



- 3.23 Appendix 2 contains an estimated borrowing profile with a long term projection of external debt, level of core reserves and internal borrowing based on current estimates.
- 3.24 The Prudential Code requires that the Council set and publish an authorised limit and operational boundary for external debt as part of the Treasury Management strategy.

### ***Treasury Management***

- 3.25 The Council manages its deposits in-house and uses Link as its independent Treasury Adviser. The Council recognises that responsibility for treasury management activities remains with the organisation. The Link contract is reviewed regularly. Full details of this activity are in the Treasury management strategy.

### **3.26 Commercial Activity**

- 3.27 Activity has focused on investments, loans in companies and purchase of further investment properties in recent years. Additional schemes are being considered alongside investment criteria which are set as part of the Treasury Management policy.
- 3.28 Activity with Partners will continue to be reviewed and increased wherever appropriate.
- 3.29 For all investments the Council considers, Security, Liquidity and Yield, ranked in that order.
- 3.30 Specifically in relation to property and loans the following criteria applies:
- **Security** – Property values are regularly monitored to ensure that the overall portfolio can recoup investment funds if necessary (Appendix 3 – paragraph 1.5). Similarly the underlying asset base for company loans is also regularly monitored.

- **Liquidity** – the Council has a well-diversified portfolio of property which is capable of being sold on the open market if necessary. Repayment obligations are assessed at the outset for loans and are regularly reviewed against latest information submitted by the companies. The Council also maintains substantial financial investments geared to meet the requirements of the medium term cash flow forecast.
- **Yield** – Return for Investment properties is represented by Rental income less direct costs and is examined on a regular basis (Appendix 3 – paragraph 1.6). Loans are measured, with reference to the Interest rate charged which is based on the Bank of England base rate plus a premium, against the return generated by financial market investments. Yield is maximised in all instances after satisfying the requirements for security and liquidity.

### ***Investment in new commercial properties***

3.31 The Council's existing portfolio has a mix between various property types (industrial/office/retail/leisure) and the nature of the investment held (e.g., directly managed occupational leases, long leasehold geared ground leases). While it achieves diversity within Cambridge, true diversification is difficult to achieve without considering a wider geographic area and associated risks and issues of investing in areas not known to the Council. The Council achieves further diversification through its investments in pooled property funds managed as part of its treasury activity, although this represents a relatively small percentage of its property investments.

3.32 Due diligence includes an examination of the mix of properties in the portfolio before new investments are entered into and Agents are appointed to carry out this work.

3.33 The key issues for new investments to be agreed with agents are:

- How an investment fits with the Council's existing portfolio, for example in terms of property type, balance of risk, future opportunities.
- Location. Ideally an investment in Cambridge but a good quality investment relatively close would be considered.
- Rate of return. The Council is looking for the best rate of return reflecting its income targets and the risk of the investment.
- Risk. Certainty of income is important and so tenant and lease structure should reflect this as should the credit ratings of tenants.
- Management. An investment should ideally not be management intensive so net income is close to gross income.
- Condition. The investment should be in good condition and not require significant capital investment in the near future unless there is a pre-let agreement underwriting such investment.
- Accessibility. The property should offer good accessibility.
- Environmental performance. The investment should have an EPC rating of C or above.

3.34 The Council has an approved process and governance arrangements for investment property acquisitions based on the pre-agreed criteria. The market is competitive and success depends upon timely decisions, therefore, the Council has delegated authority to the Head of Property Services to approve acquisitions, after consultation, with the relevant Executive Councillor, Committee Chair, Opposition Spokesperson and Head of Finance, which are then reported to the relevant Committee.

## **4. Implications**

### ***Financial Implications***

- 4.1 The Capital programme in the Budget Setting Report (BSR) examines the 5 year period 2018/19 to 2022/23 and this will be submitted to council for approval on 22 February 2019.
- 4.2 Appendix 1 highlights this information and extends it, over a 10 year period, to 2027/28 based on an annual review of likely activity carried out in 2018.
- 4.3 The HRA has a 30 Year business plan which is examined annually and this includes extrapolated information on capital expenditure for the entire period and the 10 year period is extracted from this information.
- 4.4 Cash flow has been examined as part of the Budget setting process and Appendix 2 shows the estimated borrowing profile to 2027/28. The increases in internal borrowing shown in the early part of the period reflect investment activities that are shown in detail in the 2019/20 BSR. No additional external debt has been forecast based on projected cash balances going forward particularly as Capital resources will increase in the HRA in respect of provisions for self-financing loan repayment which commences in 2038.
- 4.5 Cash Balances are reviewed regularly against future projections as part of Treasury management to ensure availability of funding for the capital programme. The position at the end of 2017/18 was as per table 1 below

Table 1: Cash Balances 31 March 2018

Cash Balance	£ 000
GF - Balance	13,381
HRA - Balance	17,174
Earmarked reserves & Provisions	40,707
Capital Receipts	40,487
Unapplied Capital Grants	5,415
<b>Total</b>	<b>117,164</b>

- 4.6 The Council's accounting policies have a de-minimis level of £15,000 (£2,000 for vehicles) for capital assets.
- 4.7 Appendix 3 contains additional information following a review of applicable activity in 2018.
- 4.8 In order to demonstrate that the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability the CIPFA Prudential Code requires that councils should have in place a capital strategy that sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and the impact on outcomes.
- 4.9 As local authorities become increasingly complex and diverse it is important that those charged with governance understand the long term context in which investment decisions are made and the financial risks to which the Council is exposed.
- 4.10 The Strategy maintains a strong and current link to the Council's priorities and to other key strategy documents including the Treasury Management Strategy, General Fund and Housing Revenue Account Medium Term Financial Strategies and the Council's Vision and Annual Statement.
- 4.11 The objective of the capital strategy is to ensure that the overall strategy, governance procedures and risk are clear to members. The strategy outlines how stewardship, value for money, prudence, sustainability and affordability will be secured

### ***Staffing Implications***

N/A

### ***Equality and Poverty Implications***

- 4.12 The overarching aims of the strategy are set in accordance with the *One Cambridge – Fair for All* vision and the principles established in the *Annual Statement* of the Council

### ***Environmental Implications***

N/A

### ***Procurement Implications***

N/A

### ***Community Safety Implications***

N/A

## **5. Consultation and communication considerations**

- 5.1 This document is not subject to direct consultation but the results of the strategy are included in the annual Budget Setting Reports which had specific consultation activities with all stakeholders.

## **6. Background papers**

- Budget Setting Report 2019/20
- Treasury Management Strategy 2019/20 to 2022/23

## **7. Appendices**

- Appendix 1 – Estimated Capital Programme 2018 to 2028
- Appendix 2 – Estimated Borrowing Profile 2018 to 2028
- Appendix 3 – 2018/19 Review of Capital activity

## **8. Inspection of papers**

To inspect the background papers or if you have a query on the report please contact Ken Trotter, Interim Deputy Head of Finance, Tel: 01223 - 458138, email: ken.trotter@cambridge.gov.uk



## Appendix 1

### Cambridge City Council - Estimated Capital programme 2018 to 2028

£'000

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
<b>General Fund Capital Expenditure</b>	43,748	21,989	15,736	2,763	5,583	2,155	3,418	3,543	1,634	3,075
<b>Housing Revenue Account Capital Expenditure</b>	36,151	51,977	67,059	30,603	22,732	22,512	21,505	22,151	23,045	20,284
<b>Capital Financing Requirement</b>	237,068	253,000	257,431	247,397	242,057	239,205	238,553	237,901	237,249	236,597

The Capital Financing Requirement shows the Council's underlying need to borrow including £213,752 for Council Dwellings under self-financing.

## Cambridge City Council - Estimated Borrowing profile 2018 to 2028

£'000

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Capital Financing Requirement</b>	237,068	253,000	257,431	247,397	242,057	239,205	238,553	237,901	237,249	236,597
<b>Comprising:</b>										
<b>External Borrowing</b>	213,572	213,572	213,572	213,572	213,572	213,572	213,572	213,572	213,572	213,572
<b>Internal Borrowing</b>	23,496	39,428	43,859	33,825	28,485	25,633	24,981	24,329	23,677	23,025
<b>General Fund Projected Year End Reserves</b>	9,367	9,081	7,823	6,476	6,009	6,622	6,600	6,600	6,600	6,600
<b>HRA Projected Year End Reserves</b>	11,090	12,494	3,019	4,571	4,649	4,756	6,150	7,192	7,539	10,940
<b>Total Reserves</b>	<b>20,457</b>	<b>21,575</b>	<b>10,842</b>	<b>11,047</b>	<b>10,658</b>	<b>11,378</b>	<b>12,750</b>	<b>13,792</b>	<b>14,139</b>	<b>17,540</b>





## Appendix 3

### 2018/19 Review of Capital activity

#### 1. Investment Properties

- 1.1 The Council has historically owned a significant investment property portfolio, including retail, office and industrial properties.
- 1.2 Given the historically low returns on financial assets, the Council has made additional investments of c£28m over the past 3 years in commercial properties. Acquisitions have been made in accordance with pre-agreed criteria in terms of how an acquisition fits with the Council's existing portfolio, management issues, tenant risk, income structure and certainty, property type, condition, location, environmental and accessibility performance, financial return and lot size. Deviance from these criteria is only allowed where an acquisition supports the Council's strategic land holdings in that location or its wider corporate aims and objectives.
- 1.3 The primary aim through commercial property investments has been income generation rather than regular property trading to release capital. As the preferred investments are to be in Cambridge, the opportunity for regular trading is limited due to market supply and so to focus on long term retention and income generation or investment in the retained portfolio is considered to best meet the Council's aims and objectives.
- 1.4 The Council has invested in a number of properties which fall outside of the city boundary. These properties are elsewhere in Cambridgeshire or in the adjacent counties of Hertfordshire and Suffolk. The Council

has taken appropriate legal advice from Counsel that these out of area purchases do not contravene the relevant legislation and the powers given to the Council under the Local Government Act 2003.

- 1.5 The total value of investment properties at 31 March 2018 was £175m. The Council considers that the investment property portfolio retains sufficient value (measured using the fair value model) to provide security of investment.
- 1.6 Based on audited financial statements the fair value of investment properties, the yield achieved (rental income net of direct costs) and the gain in fair value for properties held in the General Fund has been as follows:

Table 2: Investment property portfolio

	2017/18	2016/17	2015/16
	£ 000	£ 000	£ 000
Rental income net of direct costs	9,418	8,049	7,857
Fair Value at year end	175,281	148,345	139,046
Yield	5.4%	5.4%	5.6%
Gain in fair value in year	2,674	10,128	13,321

- 1.7 The investment property portfolio is managed as a whole, including those properties which the Council has held for a number of years. However it is estimated that the yield being achieved on properties purchased since 2015 is around 6.5% and is generating income of approximately £1.8m per annum.
- 1.8 The Council's investment in property exposes it to a number of risks including a reduction in the capital value of the asset or rental incomes due to economic conditions or excessive void periods where properties cannot be let.
- 1.9 A key element of the work of Property Services is monitoring the performance of assets to identify any that are currently held which are deemed to be under-achieving, or which are no longer appropriate to hold in the portfolio. This enables consideration to be given to alternate

uses or disposal. The Council has effectively undertaken such a process for a number of years through the annual Property Portfolio Review.

- 1.10 Performance of the portfolio in rental terms is monitored by Officers and Members via the budgetary control process.

### ***Proportionality of investment property holdings***

- 1.11 Following significant activity in the commercial property market by local authorities, including district councils, concern has been expressed by MHCLG and CIPFA about the size of some property holdings. Particular concern has been raised about those councils which are externally borrowing to invest in property. To date, Cambridge City has not used external borrowing to fund purchases, but has instead used reserves or internal borrowing.
- 1.12 Although Investment Guidance and the Prudential Code were updated in early 2018 there is a suggestion that further guidance or regulation may be issued to local authorities. This is likely to focus on the concept of 'proportionality' when considering the size and scale of new property investments and could involve the introduction of prescribed ratios.
- 1.13 However, whatever the statutory guidance, to which regard must be had, may be from time to time, and whatever the issues of interpretation to which the guidance may give rise, investment on a large scale in commercial property is an activity which requires the Council to ensure appropriate due diligence and prudence.
- 1.14 The audited financial statements at 31 March 2018 show that the Net Cost of Services chargeable to the General Fund was £23.8m. Net Income from Investment Properties was 37.8% of this figure. This is consistent with the proportion for 2016/17. The Council does not identify specific funding sources for services, so the income from properties contributed to the overall funding resources available to the Council including council tax and income from government grants and business rates. The use of investment property income to support the Council's activities has been established over many years.

1.15 The Housing Revenue Account holds a small number of investment properties valued at £5.5 million at 31 March 2018 and earning rental income of around £440k per annum.

### ***Property Portfolio Review***

1.16 The Council is currently working on a review of its property assets with external consultants. This review is in two stages and is expected to report in 2019 which will inform the 2020/21 Capital strategy as necessary.

1.17 Stage 1 is designed to consider the Council's current approach to property management and make initial recommendations for discussion with senior officers to agree the scope and direction of a more detailed review of both the Council's approach and its portfolio. This will include:

- Understanding the objectives and rationale for holding property
- An overview of the commercial portfolio from an investment perspective in terms of the balance of portfolio between property types, legal structures, and rates of return based on the risk/reward compared to the market in general
- Consideration of the Council's approach to its office accommodation and how this could be delivered in the future. This could be in the context of the Council's wider property ownership including the commercial, leisure and community portfolios
- Produce a range of options for taking forward a more detailed review of the portfolio for consideration with a clear direction from the Council as to what will/won't be acceptable for final proposals

1.18 Stage 2 is to produce a report with options available to the Council with more detailed assessment of the property portfolio and recommendations as to how the Council can improve its asset management and property performance. This will include

- Working with the Council to develop an Asset Management Plan

- A review of the commercial property portfolio to identify opportunities for development, redevelopment, disposals, acquisitions, re-gearing of leases and ways to maximise income streams with a risk balanced portfolio
- Provide recommendations for a longer term office accommodation strategy reflecting best practice and meeting the Council's objectives and aspirations. This may include rationalisation, re-location or co-location with partners
- Identify property performance measures and establish a baseline for monitoring against
- Presentation of findings to senior officers and Councillors.
- Producing hard and electronic copies of both Phase 1 & 2 reports

## **2. Treasury Management**

### ***External Debt***

- 2.1 At present the only external debt held by the authority relates to the twenty loans from the PWLB for self-financing the HRA taken out in 2012 totalling £213,572,000. These loans have maturities from 2038 to 2057 and interest rates between 3.46% and 3.53%.
- 2.2 Although the Council is not required to make MRP payments on this debt, the HRA has a 30 year business plan which demonstrates its ability to meet the costs of this debt and the options for repayment or refinancing.

### ***Internal borrowing***

- 2.3 Where the Council borrows from internal cash balances it must also ensure that it makes a prudent MRP charge. The MRP policy is included each year as part of the Treasury Management Strategy.

### ***Other Long-Term Liabilities***

- 2.4 The Council may take on liabilities in the course of the provision of operational services. Examples may include financial guarantees,

including those given in respect of subsidiaries or joint ventures. Where decisions are made for service purposes, these may be outside of normal commercial terms, including liquidity, security and/or yield.

- 2.5 Where such liabilities are taken on the Council ensures that financial risks are clearly identified and quantified along with any implied subsidy as part of the decision-making process
- 2.6 The Council manages its deposits in-house and uses Link as its independent Treasury Adviser. The Council recognises that responsibility for treasury management activities remains with the organisation. The Link contract is reviewed regularly. Full details of this activity are in the Treasury management strategy.
- 2.7 The Council's deposit priorities are (and in this order):-
- The Security of capital
  - The Liquidity of deposits
  - The Yield or return on its deposits
- 2.8 The Council takes a cautious approach within its Treasury Management Strategy. However, in order to ensure that the Council invests its funds in the most appropriate way, the Strategy is regularly reviewed taking into account the information available from Link and wider economic developments.
- 2.9 The Council uses the creditworthiness service provided by Link which is updated daily for the authority to use. This service uses a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard & Poor's. However, the Council does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:-
- Credit watches and credit outlooks from credit rating agencies
  - Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings i.e. similar to an insurance policy whereby counterparties enter into a contractual agreement

- Sovereign ratings to select counterparties from only the most creditworthy countries.
- 2.10 The Council will not generally place a material investment contrary to Link's credit methodology criteria which includes a maximum duration period.
- 2.11 In addition to considering the creditworthiness of counterparties the Council also considers the duration of deposits to ensure the appropriate liquidity of funds.
- 2.12 Treasury Management activity is delegated to officers in the Council's Finance team in line with the defined Treasury Management Practices.
- 2.13 The current investment position is reported as part of the Council's budget monitoring reporting to Senior Management Team. Investment performance is formally reported to Strategy and Resources Scrutiny Committee and Council at the mid-year and outturn.

### **3. Other Activities**

#### ***Disposals***

- 3.1 Disposal of assets is subject to scrutiny by relevant Committees and Executive Councillor approval. Detailed cases are prepared for any asset disposals and appropriate independent advice taken to ensure that best value is achieved on disposals, taking into account any strategic objectives. The Council is also obliged to sell Council properties under the Right to Buy legislation to qualifying tenants.
- 3.2 The Council's current plans for disposal include the transfer of the site purchased at Cromwell Road to CIP. There are also plans to look at the future of the Park Street car park.

#### ***Funding and borrowing restrictions***

- 3.3 There are a number of restrictions around the borrowing and funding of capital expenditure and these are taken into account in the development and monitoring of the capital plan.

- 3.4 Under the Prudential Code the Council has discretion to undertake borrowing which is prudent, affordable and sustainable from, for example, the Public Works Loan Board.
- 3.5 In respect of the Housing Revenue Account there was a 'cap' on HRA debt of £231 million. This restricted the ability of the HRA to borrow to £16m. In October 2018 the debt cap was removed subject to the normal provision that any borrowing is affordable by the HRA.
- 3.6 The majority of the receipts from asset disposal come from the sale of council homes under the Right to Buy. The Council remains subject to the agreement with The Ministry of Homes and Local Government (MHCLG) that allows the retention of right to buy receipts, subject to a set of specific conditions. These conditions include a requirement that such receipts are spent on housing.
- 3.7 The receipts assumed in the HRA Self-Financing Settlement continue to be shared with MHCLG in the statutorily agreed proportions, with a proportion of the receipts from any subsequent sales kept by the authority in recognition of the debt that the authority holds in respect of the asset. The balance of capital receipts is ring-fenced for one-for-one (1-4-1) investment.
- 3.8 Currently, 1-4-1 receipts must still be spent within a 3-year timeframe, to fund the delivery of new social housing, with a maximum of 30% of the dwelling being met via this funding stream and the balance of 70% funded from the Council's own resources or borrowing. MHCLG has recently consulted on allowing authorities longer to use existing receipts but the outcome of the consultation is awaited.
- 3.9 Failure in delivery still results in the receipt having to be paid to central government, with interest at 4% above the base rate, which far outweighs the interest earned on the receipt whilst held by the authority.
- 3.10 The Council currently aims to be around 12 months ahead of the profile for return of monies. Currently this is around 9 months.



- 3.11 If the Council fails to spend receipts in time, it may be necessary to consider some strategic acquisitions in the short-term in order to meet the deadlines, or alternatively to pursue passing some receipts to a registered provider to deliver the affordable housing in the city, in place of the Council. Any decision in this regard, will need to take account of the subsequent impact on any future Council new build schemes.
- 3.12 The Government had planned to introduce a levy on HRAs in respect of high value properties. This would have necessitated the disposal of HRA properties. A Housing Green Paper issued in summer 2018 indicated the Government's intention not to go ahead with this but the Council awaits the repeal of primary legislation in this area.
- 3.13 The Council must also ensure that it observes the ring-fence between General Fund and Housing Revenue Account resources.

#### ***Capital Receipt Flexibilities***

- 3.14 Under a direction issued by central government in February 2018 authorities can choose to use capital receipts received in the 6 years commencing from 1 April 2016 to fund the revenue costs of transformation projects. Qualifying expenditure must 'generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that will reduce costs or demand for services in future years for any of the public sector delivery partners.'
- 3.15 The Council does not currently plan to take advantage of this flexibility given the low levels of General Fund capital receipts it holds. This position can be kept under review. Any decision to take advantage of the flexibility would require the development of a strategy to be approved by full Council.

#### ***Loans to group undertakings***

- 3.16 The Council has made and plans to make further loans to a number of group undertakings. These loans include

- A loan of £7.5m to Cambridge City Housing Company. This loan is secured on the properties owned by CCHC and pays an interest rate of 2.02% per annum.
- To facilitate the redevelopment of the Council's former depot site at Mill Road the Council has issued a £5.2 m loan note to the Cambridge Investment Partnership (CIP) -a joint venture and deadlock partnership in which the Council has a 50% stake.
- The Council is budgeted to make further capital contributions and loans to the CIP. These payments are classed as capital expenditure. The payments are appropriately covered by assets in the CIP and there are detailed plans to demonstrate that all investment in the CIP will be recovered in less than five years with any surplus paid to the Council.
- It is also likely that the Council will make similar arrangements with CIP to those made in respect of Mill Road, for the Cromwell Road site.

### ***Other Long-Term Liabilities***

- 3.17 The Council may take on liabilities in the course of the provision of operational services. Examples may include financial guarantees, including those given in respect of subsidiaries or joint ventures. Where decisions are made for service purposes, these may be outside of normal commercial terms, including liquidity, security and/or yield.
- 3.18 Where such liabilities are taken on the Council ensures that financial risks are clearly identified and quantified along with any implied subsidy as part of the decision-making process.
- 3.19 The Council has given financial guarantees in respect of the pension contributions due from Visit Cambridge and Beyond and Cambridge Live in the event of their winding up or liquidation.

- 3.20 The Council has also advanced a number of interest free loans in respect of improvements to private sector properties. Although there is a small cost to the authority in terms of lost interest, the loans are secured on the properties and are therefore considered to be of low financial risk to the Council. Each loan is less than £20,000.
- 3.21 The Council has advanced a number of loans to limited liability partnerships it has set up with Hill Residential under the Cambridge Investment Partnership umbrella to facilitate redevelopment of sites for housing. A number of these loans are interest free. The Council uses detailed models to assess the viability and monitor CIP schemes and is compensated in these schemes by a shared of the surpluses at the end of the development.

### ***Knowledge and Skills***

#### ***Treasury Management***

- 3.22 Treasury Management Activity is undertaken by an Accountant and Assistant Accountant in the Council's Technical and Financial Accounting Team. They are managed by a CCAB qualified accountant.
- 3.23 The team has many years of treasury management experience and has recently demonstrated that it has the skills to opt-up to Professional status under the MiFID II reforms.
- 3.24 The CIPFA Code requires the responsible officer to ensure that Members and Officers are adequately trained in treasury management. Training is arranged as required and is regularly reviewed.

#### ***Property Assets***

- 3.25 The Council's investment property is managed by its Property Services Team, an experienced team of 8 staff. The team includes 6 Chartered Surveyors each with over 25 years of property experience in both the private and public sector. This extensive experience includes dealing with a mix of property types and professional work including

professional services, landlord and tenant, statutory valuations, acquisitions and disposals, commercial and residential property management. They have extensive knowledge of the Cambridge property market with most of the team having worked in and around Cambridge for the past 10 years or so, some much longer.

3.26 Property Services also works with external agents where specialist expertise is required to deal with particular properties or resource is not available to deal with matters in a timely way. Examples of where external advice is used include agency, valuation, building surveying and planning work. The Council also has internal building surveying resource in its Estates and Facilities Team to advise on construction, repair and maintenance, and statutory compliance matters across its investment properties. Estates and Facilities commission and manage repairs and maintenance as well as capital investment programmes either directly or through framework contracts.

3.27 The Council's asset valuations for its financial statement are prepared by external agents with an agreed rolling programme of valuations for the whole Council property portfolio. All material investment properties are valued on an annual basis.

3.28 When acquiring new investment property, the Council has appointed external agents to advise on and negotiate the terms of acquisition, recognising that others are closer to the investment market on a day to day basis than the Council's in-house team in some cases. As well as advising prior to acquisition, the agents undertake due diligence which helps to ensure that those charged with governance can make informed decisions.

### ***External advice***

3.29 In addition to the use of external agents in the purchase of investment properties the Council makes use of other external advice as necessary for capital and treasury activity. This includes getting appropriate legal and other professional advice on more complex projects and capital transactions and the appointment of Treasury Management advisors.