Cambridge City Council
Capital Strategy 2022/23

Contents

1. Introduction

1.1 The CIPFA Prudential Code requires that councils have a capital strategy that demonstrates 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 strategy should set out the long-term context in which capital expenditure and investment decisions are made and give due consideration to both risk and reward and the impact on outcomes.

1.2 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.

1.3 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.

2 Objectives

2.1 The objective of the capital strategy is to ensure that the overall strategy, governance procedures and risk appetite are clear to members, officers and readers in general. The strategy outlines how stewardship, value for money, prudence, sustainability and affordability will be secured.

3 Scope

3.1 The capital strategy specifically focusses on the key areas of:

- Capital expenditure
  - Investments for service purposes
  - Investments for commercial purposes
- Debt, borrowing and treasury management;
  - Investments for treasury management purposes

It also considers:

- Other long-term liabilities; and
- Knowledge and skills.

Capital Expenditure

3.2 Capital expenditure (or investments) may be for service or commercial purposes. The CIPFA Prudential Code defines these as follows:

Investments for service purposes *(or service investments) are taken or held primarily and directly for the delivery of public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services. Service investments may or may not involve financial returns; however, obtaining those returns will not be the primary purpose of the investment.*

Investments for commercial purposes' *(or commercial investments) are taken or held primarily for financial return and are not linked to treasury management activity or directly part of delivering services. This includes non-financial assets such as commercial property, where they are held primarily for financial return. Commercial in this context refers to the purpose of the investment. Commercial investments are not taken to meet treasury management cash flow needs, and do not result from treasury risk management activity to prudently manage the risks, costs or income from existing or forecast debt or treasury investments. They are additional investments voluntarily taken primarily in order to generate net financial return or profit.*

3.3 The council runs a majority of services in house and has a significant operational asset base to run and sustain those services - including administrative offices, operation depots, council houses, 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.

3.4 The council may purchase or develop new assets, for example community centres in new areas of the city, or purchase or enhance existing investment properties to address building/functional/economic obsolescence, support regeneration of the local area and which in addition may generate additional income to support Council services.

3.5 There has been an emerging commercialisation agenda in local government in the last few years as councils look to become more financially self-sufficient. The City Council has focused on loans to council joint ventures and companies wholly owned by the council. It completed a programme of acquisition of investment properties in 2019 in accordance with its asset management plan to improve diversity of the portfolio or as strategically important to future portfolio performance. The council is considering investment in renewable energy generation and associated areas as part of its response to the Climate Emergency.

3.6 The council may make grants, loans or investments which are treated as capital expenditure under statute.

Debt, Borrowing and Treasury Management

3.7 The CIPFA Prudential Code includes the following definition:

Investments for treasury management purposes *are those investments that arise from the organisation's cash flows or treasury risk management activity, and ultimately represent balances that need to be invested until the cash is required for use in the course of business. Treasury investments may include an allowance for a reasonable level of short-term investments to provide access to liquidity.*

3.8 The council has both external borrowing from the Public Works Loan Board (PWLB) and 'internal' borrowing from cash balances. This borrowing is managed alongside the investment of cash balances (currently over £100m per annum) as part of the council's treasury management function.

3.9 The council has committed to borrowing from a financial institution to fund the redevelopment of the Park Street multi-storey car park. The loan will be drawn down between April 2024 and December 2025 in line with expected expenditure on the project.

4 Council priorities and external Influences

4.1 The Council has an overall Vision statement – 'One Cambridge – Fair for All', in which economic dynamism and prosperity are combined with social justice and equality. The vision can be viewed at www.cambridge.gov.uk/our-vision

4.2 The revised Corporate Plan 2022-27 sets out four key priorities and how they will be delivered.

- Tackling poverty & inequality and helping people in the greatest need

- Leading Cambridge's response to the climate change and biodiversity emergencies
- Building a new generation of council homes and reducing homelessness
- Transformation and Recovery
  - Leading a sustainable and inclusive recovery
  - Transforming the council, to continue delivering our priorities and providing quality services within financial constraints

The Corporate Plan can be accessed at https://www.cambridge.gov.uk/corporate-plan.

4.3 As part of the Transformation priority, the council is developing the 'Our Cambridge' transformation programme. Whilst strongly focused on the delivery of revenue savings and efficiencies and collaborative working with partners, it will seek to 'right-size' the council's administrative and operational estate in line with the needs of transformed services, as well as to procure and implement ICT systems to support the digitalisation of services.

4.4 A review of the existing capital plan will be undertaken in 2022/23 to identify and remove schemes that are no longer in line with current priorities, releasing capital funding and other resources.

Local Plan and North East Cambridge (NEC)

4.5 The Cambridge Local Plan was adopted in October 2018. The council will now use the local plan to guide development in the city in the coming years, with 14,000 additional homes and 22,000 additional jobs set to be created by 2031. The process to develop a new local plan with South Cambridgeshire District Council, to be known as the Greater Cambridge Local Plan, has begun. This included an initial consultation held in January and February 2020, and publication of an initial evidence base and strategic options assessments in November 2020. A full public consultation on the first proposals for the plan was held in November and December

2021. A full draft plan will be developed during 2022. Further information can be found at https://www.greatercambridgeplanning.org/emerging-plans-and-guidance/greater-cambridge-local-plan/.

4.6 Among the areas designated in the emerging local plan for potential future development is the NEC area around Cambridge North Station. The North East Cambridge Area action plan suggests the future potential for around 8350 homes and an additional 15000 jobs in the area, close to key employment sites and sustainable transport modes. The council, working with partners, has secured £227m in national funding to support the relocation of Anglian Water's Cambridge Water Recycling Centre to enable the sustainable development of the area. Subject to the relocation being achieved, development proposals emerging for the Core Site (48ha at the centre of the NEC AAP area, jointly owned by the Council and Anglian Water) may include around 5200 homes as part of a mixed use scheme, creating over 4000 jobs. This scale of development would make a significant contribution to the additional homes and jobs likely to be required by the new Local Plan.

4.7 As a significant landowner in the area the project to develop NEC will be important in the council's future capital plans. This is both in terms of capital expenditure and as a source of funding in the form of capital or other receipts.

Delivery of new council homes

4.8 The council secured £70m of devolution grant towards the provision of 500 new council houses in Cambridge. This funding is being used alongside right to buy receipts and other HRA resources. At December 2021, 138 new council homes have been delivered with a net gain of 107. A further 464 homes are on site, with a net gain of 419 homes being delivered.

4.9 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 undertaking the redevelopment of the council's former depot at Mill Road which is providing an equal number of market and council homes. A number of both the market and affordable homes are now occupied.

4.10 The council purchased a site at Cromwell Road which it is currently redeveloping with CIP to provide 295 units, 40% of which will be new council homes. CIP has also purchased a further site, L2 on Orchard Park for development for homes, 40% of which will be new council homes.

4.11 The council is currently undertaking redevelopment of the Meadows and Buchan Street community centre sites to deliver over 100 new council homes, a community hub and to re-provide local retail / commercial premises.

4.12 The council is also working on a new programme to deliver 1,000 new council homes over the course of the decade from 2022 to follow on from the end of the current 500 housebuilding programme. New homes will be built to a Passivhaus standard where possible, with an intention to move to zero carbon during the life of the programme where possible and feasible to do so. Current assumptions indicate that the council will need to borrow at least £347m, alongside Homes England Grant funding and the use of Right to Buy receipts, in order to deliver this programme.

Other capital priorities

4.13 In addition to the major developments above for the delivery of new homes and businesses in Cambridge, the council is also planning and implementing a number of significant enabling investments to drive digital delivery and service improvement. This includes investment in new IT equipment to promote flexible and collaborative working under the umbrellas of 'Council

Anywhere' and 'Our Cambridge' and the replacement of a number of key systems including the housing management system.

4.14 The council uses condition surveys and asset management planning for both the Housing Revenue Account (HRA), covering the council's 7,000 council houses, and the General Fund (GF) to inform priorities for capital expenditure.

4.15 The council remains fully committed to increasing energy efficiency, reducing the carbon footprint and improving sustainability across the asset portfolio. The council undertakes energy efficiency and carbon reduction work on council buildings with funding allocated from the Climate Change Fund, grants and other resources, as available. The council also undertakes energy efficiency work on its commercial property portfolio to ensure compliance with the statutory requirements of the MEES legislation.

4.16 The council has commissioned a study for improving the energy performance of council homes across seven archetypes. 521 non-traditional properties and hostels have been excluded as the costs for these properties are considered to be unpredictable and need to be explored separately. The anticipated investment required is between £365m and £512m depending upon the option selected. The funding for this level of investment is not currently available and borrowing to this level is not financially viable. The council is exploring options and will apply for any external funding that is made available in this area.

4.17 The council will continue to bring forward projects, including those targeted on energy saving and generation, within the council's property estate and in other locations where an environmental, social or financial benefit may be derived.

Working with external partners

4.18 The council works closely with external partners and this extends to decisions around capital.

4.19 The council has worked closely with the Cambridgeshire and Peterborough Combined Authority on the project to develop NEC, which was prioritised by the Combined Authority as its only submission in the round of funding bids for the Housing Infrastructure Fund.

4.20 The council is involved in a number of shared services with Huntingdonshire District Council and South Cambridgeshire District Council under the 3Cs Shared Services name. Further services are shared with either South Cambridgeshire alone or Huntingdonshire alone. Where these services require capital investment, the councils work closely together.

5 Capital expenditure

Governance

5.1 Capital projects put forward for funding through the Medium Term Financial Strategy (MTFS) or Budget Setting Report (BSR) must:

- Be linked to the council's vision and address other strategic considerations, including impact on the climate;
- maintain or enhance service delivery;
- be properly planned and developed and appropriate risks considered;
- be affordable and provide value for money; and
- be ready to be implemented, subject to any procurement requirements.

5.2 The council has a process for the review and prioritisation of new capital projects or programmes prior to approval by members. These arrangements are coordinated by the council's Corporate Programme Office (CPO). The objectives of the process include ensuring that the council has the capacity to deliver projects which are approved for inclusion on the capital plan. Review of capital proposals also ensures that the sensitivity of costs to both internal and external risks is considered.

5.3 Under the process one of the programme boards will review and make recommendations for the political approval that is required and funding approval in the BSR or MTFS. The CPO and a virtual Quality Assurance Group (QAG) reviews projects prior to presentation to the relevant board.

5.4 Boards have responsibility for monitoring the delivery of projects and ensure 'lessons learned' reviews take place to identify both good practice and areas for improvement. These reviews are shared to inform decision making on future projects.

5.5 The council's accounting policies have a de minimis of £15,000 (£2,000 for vehicles) for capital assets which are reflected in the processes above.

5.6 Where projects are to be funded by S106 contributions they are allocated S106 funding via the S106 priority-setting process by the Executive Councillor in the appropriate scrutiny committee.

5.7 The HRA capital programme is scrutinised by the Housing Leaders (Senior Management) Team and Housing Scrutiny Committee prior to decisions being taken as part of the Housing BSR and MTFS.

Financing of capital expenditure

5.8 Consideration of the financing of capital projects is integral to the governance procedures outlined above.

5.9 For 2021/22 and later years, the council will normally no longer finance GF capital expenditure from in-year revenue funding. Where specific funding, such as grants or capital contributions are available, these will be used. Other capital expenditure will be financed from capital receipts and internal or external borrowing. To ensure that capital expenditure is both affordable and prudent, an annual limit of capital financing from capital receipts and borrowing will be set and reviewed annually through the Medium Term Financial Strategy (MTFS).

5.10 Available resources will be allocated to capital proposals based on the following hierarchy of objectives:

- Statutory requirements e.g. Health and Safety;
- Maintenance of service delivery capacity and capability;
- The delivery of wider policy objectives, including those related to climate change and biodiversity; and then
- Income generation to support the delivery of council objectives.

5.11 Work with Heads of Service on forecasting possible GF 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 forecast will however be dependent on future decisions relating to service delivery, so will be kept under annual review and will feed into consideration of the capital expenditure limit referred to above.

5.12 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 will be used mainly to ensure that the existing stock meets decent homes standards and to build new homes. The HRA will also use direct revenue funding from its revenue resources and an element of borrowing to support reprovision of existing units (which cannot be funded from right to buy receipts) and wider investment on housing estates. This is in addition to any external funding sources, such as Homes England grant.

5.13 Where the council identifies that GF capital expenditure is to be supported by borrowing, either externally or internally from cash, a prudent Minimum Revenue Provision (MRP) charge will be made to revenue to fund the expenditure. This will ensure that the council makes appropriate provision to fund the repayment of external debt or 'repay' cash balances internally borrowed. There will be circumstances in which MRP is not judged to be required. If so, the reasons will be specifically outlined in the MRP Policy. The MRP policy is published each year as part of the Treasury Management Strategy.

5.14 The Prudential Code requires that the council set and publish prudential indicators for capital expenditure as follows. These can be found in the annual treasury management strategy.

- Estimate of total capital expenditure to be incurred in years 1, 2 and 3
- Actual capital expenditure for 20xx/20xx
- Estimate of capital financing requirement as at the end of years 1, 2 and 3.
- Actual capital financing requirement as at xx/xx/xx

5.15 Further prudential indicators are required relating to the affordability of capital expenditure.

- Estimates of financing costs to net revenue stream for years 1, 2 and 3
- Actual financing costs to actual net revenue stream
- Estimates of net income from commercial and service investments to net revenue stream for years 1, 2 and 3
- Actual net income from commercial and service investments to net revenue stream

Asset management planning

5.16 The council's GF asset management plan was approved in July 2019, following an independent review of the council's property portfolio covering both operational and commercial properties. It will be reviewed every five years.

5.17 The asset management plan outlines how the council will manage its property. The plan sets out:

- The guiding principles of efficient management and the components and tools available to deliver results
- How the council’s objectives are supported, both in respect of property and its wider corporate objectives
- The objectives of the commercial property portfolio and the regular reviews to be undertaken to assess how the portfolio meets these objectives
- Property management including KPIs, the objectives, principles and process of acquisition, property reviews, asset management, development and disposals
- Portfolio-wide matters such as repair and maintenance, health and safety, carbon management and sustainability and property data management.

5.18 The GF asset management plan is being reviewed and updated to enable a revised corporate asset management plan to be produced which will include a 30-year maintenance plan for all the buildings, including a full assessment of the work required to ensure that the council meets its ambitious 2030 target to reach net zero carbon. The first stage of the review will focus on buildings emitting high levels of carbon dioxide and those which use gas boilers.

5.19 The HRA asset management plan for housing stock was also reviewed and updated in 2019. The plan aims to return to a partial investment standard model rather than the basic decent homes standard, ensuring that the council invests in the current housing stock at the appropriate time and in the long term to reduce the level of spend in revenue repairs and maintenance.

5.20 The updated HRA asset management plan increases focus on improving the energy efficiency of the stock and compliance with relevant regulations, including fire safety. As this is a developing area following the Grenfell fire, the plan will be reviewed and updated once changes in regulations and other compliance requirements are published.

5.21 Initial work has been undertaken to understand the level of investment that will be required to move existing homes towards Passivhaus or net zero carbon standards through retrofit, so that this can be balanced against the aspiration to also deliver new build homes to the highest sustainability standards possible, within resource constraints (see also para 4.15).

5.22 The council will review the condition of its existing assets on a regular basis, using specialist advisors where appropriate. This includes reviews of the maintenance requirements of operational property, investment properties and council housing stock.

5.23 Maintenance costs of existing assets will be 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 will 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.

5.24 With the exception of the £214m loans taken out on the inception of self-financing of the HRA 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.

Forecasts

5.25 Forecasts of capital expenditure and the underlying need to borrow, also known as the Capital Financing Requirement (CFR), are included at Appendix 1.

Disposals

5.26 Disposal of assets will be subject to scrutiny by relevant committees and Executive Councillor approval. Detailed cases will be prepared for any asset disposals and where 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 to qualifying tenants under the Right to Buy legislation.

Use of capital receipts

5.27 Capital receipts may only be used for capital purposes. The council will also ensure that it observes the ring-fence between GF and HRA resources.

5.28 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 Department of Levelling-Up, Housing and Communities (DLUHC) 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.

5.29 The receipts assumed in the HRA Self-Financing Settlement continue to be shared with DLUHC 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.

5.30 Currently, 1-4-1 receipts must be spent within a five-year timeframe to fund the delivery of new social housing. A maximum of 30% of the cost can be met from this funding stream with the balance funded from the council’s own resources or borrowing.

5.31 Where receipts are not used within the five-year timeframe, receipts have to be repaid to central government with interest at 4% above the base rate.

5.32 The council aims to be around 12 months ahead of the profile for return of monies but this is critically dependent on the progress of housing developments that may be affected by factors outside the council's control. If the council is unable to use receipts within the five-year timeframe, it will either acquire existing properties on the open market or look to pass receipts on to a registered provider to deliver affordable housing in the city. Following changes introduced in the pooling regime, there will be a cap on the number of homes that can be acquired on the open market using these resources each year, to be phased in from April 2022. All efforts will be made to ensure that no receipts are paid back to central government.

Capital receipt flexibilities

5.33 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.'

5.34 The council has no plans to use this flexibility.

6 Debt, borrowing and treasury management

Summary

6.1 Appendix 1 shows a summary of the council's total underlying need to borrow – the Capital Financing Requirement (CFR), together with the estimated levels of borrowing and the level of protection provided by reserves.

6.2 The Prudential Code requires that the council set and publish the following prudential indicators for external debt. These can be found in the annual treasury management strategy.

- Authorised limit for external debt for years 1, 2 and 3
- Operational boundary for external debt for years 1, 2 and 3
- Actual external debt as at xx/xx/xx
- Comparison of gross debt and the capital financing requirement

External debt

6.3 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.

6.4 These loans have maturities from 2038 to 2057 and interest rates between 3.46% and 3.53%.

6.5 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 on-going financing costs of this debt and considers the options for repayment or refinancing.

6.6 The council will borrow to support capital expenditure where prudent and affordable to do so. The council will identify the best source of borrowing to meet its requirements at the time.

6.7 The change to capital financing outlined in 5.9 will give rise to additional external borrowing. This will be dependent on the timing and level of capital receipts achieved, the level of cash balances held and the timing of delivery of capital schemes. Estimates of external debt are included in the treasury management strategy.

Internal borrowing

6.8 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.

Funding and borrowing restrictions

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

6.10 Under the Prudential Code the council has discretion to undertake borrowing which is prudent, affordable and sustainable. However, the Code specifies that it is not prudent for an authority to borrow to invest primarily for financial return. The council will therefore only undertake borrowing that is directly and primarily related to the functions of the council and any financial returns will be either be related to the financial viability of the project or incidental to the primary purpose.

6.11 The PWLB's current lending terms require councils to confirm that they have no plans for capital schemes that can be classified primarily as 'debt for yield' investments before any loans are agreed.

6.12 Guidance indicates that the purchase of assets primarily for yield would usually have one or more of the following characteristics:

- Buying land or existing buildings to let out at market rate
- Buying land or existing buildings which were previously operated on a commercial basis which is then continued by the local authority without any additional investment or modification
- Buying land or existing buildings other then housing which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger such as the completion of land assembly

6.13 At present, no schemes of this types are included in the council's capital programme.

6.14 With the removal of the HRA debt ‘cap’ in October 2018, the HRA is able to borrow to fund its capital plans, subject to the normal provision that any borrowing is affordable.

Treasury management

6.15 The council manages its deposits in-house and uses Link (formerly Capita) as its independent treasury adviser. The council recognises that responsibility for treasury management activities remains with the organisation. The council will ensure that the terms of Link’s appointment are properly agreed, documented and reviewed annually.

6.16 The council’s deposit priorities are (and in this order):-

- The security of capital;
- The liquidity of deposits; and;
- The yield or return on its deposits.

6.17 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 will be reviewed at least annually taking into account the information available from Link and wider developments.

6.18 The council will use the creditworthiness service provided by Link which is updated daily for the authority to use. The 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. akin to an insurance policy whereby counterparties enter into a contractual agreement; and;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.19 The council will not place an investment contrary to Link's credit methodology criteria which includes a maximum duration period (except for 'smaller' building societies).

6.20 In addition to considering the creditworthiness of counterparties the council will also consider the duration of deposits to ensure the appropriate liquidity of funds.

6.21 Treasury management activity will be delegated to officers in the council's finance team in line with the defined treasury management practices.

6.22 The current investment position will be reported to the Senior Management Team as part of the council's quarterly budget monitoring process. Investment performance will be formally reported to Strategy and Resources Scrutiny Committee and Council at the mid-year and outturn.

7 Commercial activity

7.1 Where the council invests in non-financial assets, it will consider security, liquidity and yield, as it does for financial assets.

7.2 Specifically, in relation to non-financial assets:

- **Security** – the council recognises that it will normally have an asset that can be used to recoup capital invested. Therefore, it will ensure through regular valuations at fair value, that there is sufficient value in assets and the portfolio as a whole to protect the funds invested.

- **Liquidity** – the council has a large diversified portfolio of non-financial assets and will therefore be able to look at potential disposals across it to access funds, without having to rely on the disposal of a key asset for liquidity. The council will also maintain significant financial investments to meet its liquidity needs.

- **Yield** – Return for non-financial assets is represented by rental income less direct costs and will reviewed on a regular basis. Yield will be appropriate to the perceived level of risk for the asset in the market at that time, within any constraints imposed by policy decisions, after satisfying the requirements for security and liquidity.

7.3 The council considers commercial activity to include:

- The provision of income-generating services, such as car parking and bereavement services, which utilise significant assets. These assets are classified as *service investments* under the Prudential Code and as operational assets for management purposes.
- Investment in commercial properties through acquisition but also through portfolio management (recycling portfolio performance through buying and selling) and regeneration or redevelopment of the existing portfolio. These assets are classified as *commercial investments* under the Prudential Code.
- Investment in other income-generating assets that support council objectives, such as housing and renewable energy generation facilities. These are classified as service investments under the Prudential Code.
- Loans to group undertakings, classified as *service investments*.

<u>Investment in commercial properties</u>

7.4 The council has historically owned a significant investment property portfolio, including retail, office and industrial properties. The GF asset management plan identifies the following objectives for the commercial property portfolio:

- Securing a financial return from the net rental income
- Diversification (geographic, property type, tenure) to mitigate stock specific risk
- Meeting wider corporate objectives such as improving environmental performance and sustainability by providing high performing property
- Delivery of services to the citizens in accordance with objectives
- Opportunity to influence through wider land ownership
- Providing opportunities for entrepreneurs and small businesses which may not always be available through the private sector
- Ensuring appropriate standards of property management are maintained including but not limited to environmental and health and safety standards and legislation
- Improving the quality of the public realm.

7.5 The GF asset management plan sets out criteria and procedures for property acquisitions. Where new acquisitions are to be made, agents will be appointed to advise on and acquire suitable commercial property investments.

7.6 As there are many factors to consider, a weighted scored matrix will be used to assess potential acquisitions. Acquisitions should generally meet the following requirements, but exceptions may be made where an acquisition is strategically important in relation to the council’s existing land ownership or portfolio balance:

- Location: investment in Cambridge but a good quality investment relatively close can be considered.
- Rate of return: at least 5% p.a. on capital value
- Risk: certainty of income, as reflected by tenant and lease structure and the credit ratings of tenants

- Management: net income close to gross income, property management requirements not intensive.
- Condition: in good condition, not requiring significant capital investment
- Accessibility: good
- Environmental performance: EPC rating of C or above.

7.7 Consideration will also be given to how the acquisition will fit within the council's existing portfolio. Specific portfolio key performance indicators (KPIs) are given in the monitoring portfolio performance section below.

7.8 The council will follow the approved process and governance arrangements for investment property acquisitions when funding is available for investment. These recognise that the local commercial property market is competitive, and that success depends upon timely decisions in relation to investments. The council has previously therefore delegated authority for acquisition programmes to the Head of Property Services to approve acquisitions after consultation with the relevant Executive Councillor, Committee Chair, Opposition Spokesperson and Head of Finance. Subsequently, acquisitions will be reported to the relevant committee.

7.9 In order to achieve some geographical diversity, the council has invested in properties which fall outside the city boundary. The council took 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. The council also achieves some wider geographic 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.

7.10 The council is redeveloping an operational asset, the multi-storey car park it owns on Park Street in Cambridge. The car park will be replaced by a smaller underground car park, with an aparthotel above, achieving significant regeneration, environmental and public realm improvement in the area. Once complete, the aparthotel will form part of the council's investment portfolio in an under-represented property type, with rentals for the hotel servicing the borrowing required to undertake the development.

7.11 The council will develop commercial land and property it already owns. A programme of nine projects has been identified to produce new or extended commercial property which is in short supply in the city. Some projects will be mixed use schemes, including residential accommodation some of which may be sold to partially fund the developments. The programme is expected to span 10 years, cost c£30m, generate capital receipts of £24m and increase annual rent income by £900,000. Further feasibility and development work will be required before individual projects within the programme can come forward for consideration and approval.

Monitoring portfolio performance

7.12 The portfolio will be reviewed annually as a whole by classification, lot size range, bandings and average, sector mix, geography, lease type and repairing obligations, net income return, average unexpired lease term, percentage void and compared with previous years. This will identify portfolio imbalances. A new property management database is being procured to support the delivery of the asset management plan and associated KPIs.

7.13 The following portfolio KPIs, as included within the GF asset management plan, will be introduced:

Measure	Target / Baseline	Comment	Frequency
Gross external debt to net service expenditure	N/A	Not currently relevant due to the revised PWLB lending terms – see para 5.25	Annually
Commercial property income to net service expenditure	<50%		Annually

Measure	Target / Baseline	Comment	Frequency
Ratio of investments to the resources of the council	<30%	Fair value of investment property as a % of the council's net assets.	Annually
Ratio of external borrowing to portfolio value	N/A	Not currently relevant due to the revised PWLB lending terms – see para 5.25	Annually
% outside jurisdiction	<25%	To maintain Cambridge focus with economic benefits too but also diversity from local economy and achieve stronger yield	Annually
Net income return	>5% on current capital value	To maintain income levels	Annually
Average unexpired lease term	>5 years	Target is income security	Annually
% investment grade property	>80%	Generally lower expenditure	Annually
% void	<£100,000 income	To maintain income levels	Quarterly
Largest lot size	<10% of portfolio	Excluding Lion Yard. To reduce specific stock risk	Annually
Cashflow target (if set)	Meet target within 20%	To achieve the net investment level	Annually
Sector	No more than 50% in any sector, retail to trend downwards towards 30%	To diversify sector risk	Annually

7.14 The council's sizeable property portfolio includes equity stakes in two major shopping centres, a selection of small business units aimed principally at small local and start-up companies and more than 80 shops in council estate locations which provide important local services for their communities.

7.15 The total value of investment properties at 31 March 2021 was £159m. The council considers that the investment property portfolio retains sufficient value (measured using the fair value model) to provide security of investment.

7.16 Based on the council's financial statements the fair value of investment properties, the yield achieved (rental income net of direct costs) and the gain or loss in fair value for properties has been as follows:

	2020/21	**2019/20**	**2018/19**	**2017/18**	**2016/17**
Rental income net of direct costs (£'000)	9,315	9,603	9,984	9,418	8,448
Fair Value at year end (£'000)	158,594	162,722	170,782	175,281	148,345
Yield	5.9%	5.9%	5.9%	5.4%	5.5%
Gain / (loss) in fair value in year (£'000)	(4,128)	(8,060)	(4,499)	21,575	9,432

7.17 The loss in fair value from 2019/20 reflects exposure to retail through its significant shopping centre investments as well as market uncertainty in relation to both the Brexit process and the COVID-19 pandemic. As such, some reductions are likely to be temporary, but may take some time to reverse while others represent more of a structural change as markets adjust.

7.18 The investment property portfolio is managed as a whole, including those properties which the council has held for a number of years. The more recent acquisitions are considered to have stabilised the rate of return as their acquisition was aligned with the criteria set out in 7.6 above compared to the historic portfolio.

Proportionality of commercial property holdings

7.19 Following significant activity in the commercial property market by local authorities, including district councils, concern has been expressed by DLUHC 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. Cambridge City has not used external borrowing to fund purchases but has instead used reserves or internal borrowing.

7.20 CIPFA released guidance on prudential property investment in 2019. This considers the concept of 'proportionality' when considering the size and scale of new property investments, whether they are consistent with the authority's corporate and financial strategies and if they expose the authority to unacceptable levels of risk.

7.21 The council is aware of the range of risks associated with investment in commercial property and works to ensure appropriate due diligence and prudence. These risks include the reliance on income from commercial properties to fund council services. It has also sought to provide greater diversification of risk through its more recent portfolio acquisitions in terms of property type, location, management costs and covenant strength.

7.22 The use of investment property income to support the council's activities has been established over many years and over a number of economic cycles. Reflecting this experience, the council considers 50% to be the prudent maximum level of this indicator.

7.23 The financial statements at 31 March 2021 show that the net cost of services (net of service-related income) chargeable to the GF was £33.4m (2020 £23.3m). Net income from investment properties was 26.6% (2020 39.4%) of this figure. The significant decrease in this indicator is the result of the significant increase in net cost of services due to the Covid-19 pandemic.

7.24 The HRA holds a small number of investment properties, mainly retail units linked to council housing, for example shops with flats above. These properties are valued at £5.9 million at 31 March 2021 and earn rental income of around £440k per annum.

Other income generating assets

7.25 The council is developing housing through the Cambridge Investment Partnership (CIP) – a joint venture and deadlock partnership in which the council has a 50% stake. Affordable housing on these sites will be owned and managed by the council's HRA, contributing towards the council's target of 500 new council homes. Market housing will be sold to generate surpluses, 50% of which will return to the council to support further capital expenditure. The council will continue to work with the CIP to identify and bring forward appropriate development projects.

7.26 The council has a wholly-owned subsidiary company, the Cambridge City Housing Company (CCHC), which owns residential properties in Cambridge. These are let on affordable rents to those who cannot afford local market rents but are unlikely to be allocated council housing. The company has two objectives, the provision of affordable rented housing and a financial return to the council.

7.27 The company currently owns 23 properties and leases 4 properties from the HRA, specifically to house homeless individuals with support needs. Subject to viability considerations and the availability of suitable properties, the council will consider providing the company with further funding to purchase residential properties.

7.28 The council is investigating options for investment in renewable energy schemes. Appropriate independent advice will be sought to support the council is assessing potential investments, particularly with regard to risks and their mitigation.

Loans to group undertakings

7.29 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 CCHC: this loan is secured on the properties owned by CCHC and pays an interest rate of 2.02% per annum. It is due for refinancing in April 2022.
- A £5.2 m loan note to CIP: to facilitate the redevelopment of the council's former depot site at Mill Road. No interest is payable on this loan.
- An interest-bearing loan note of £27m to CIP: to enable housing development on the Cromwell Road site
- Interest-bearing capital contributions and loans to the CIP to fund development on these two sites and L2. The payments are appropriately covered by assets in CIP and there are detailed plans to demonstrate that all investment in the CIP will be recovered in less than five years with a surplus paid to the council.

8 Other long-term liabilities

8.1 The council will take on liabilities in the course of the provision of operational services. Examples 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.

8.2 Where such liabilities are taken on the council will ensure that financial risks are clearly identified and quantified along with any implied subsidy as part of the decision-making process.

9 Knowledge and skills

S151 Officer

9.1 The council's S151 officer is required to report explicitly on the affordability and risk associated with the capital strategy. The S151 officer is an experienced CCAB qualified accountant with statutory responsibilities for the proper administration of the council's financial affairs and for advising the council on budgetary matters. As such the S151 officer oversees the council's capital expenditure and investment activities and ensures that professional advice is obtained where the council does not have the necessary skills in house.

Treasury management

9.2 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.

9.3 The team has many years of treasury management experience and has demonstrated that it has the skills to opt-up to professional status under the MiFID II reforms.

9.4 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

9.5 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.

9.6 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.

9.7 The council's asset valuations for its financial statements 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. has recently appointed new external agents for its asset valuations which should bring fresh objectivity and challenge to its valuations.

9.8 When acquiring new investment property, the council appoints 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

9.9 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.

Appendix 1

Estimated Capital Programme, Capital Financing Requirement and Reserves - 2021 to 2031

£'000	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
General Fund Capital Expenditure	100,954	36,734	49,554	15,190	19,411	19,100	3,721	4,328	3,823	4,433
Housing Revenue Account Capital Expenditure	61,080	96,204	67,598	150,717	195,882	237,497	118,263	44,661	41,679	45,555
Capital Financing Requirement	330,771	336,744	347,231	398,370	493,563	679,336	633,358	589,969	590,073	600,418
General Fund Projected Year End Reserves	20,048	24,073	24,896	25,974	27,379	28,784	30,189	31,594	32,999	34,404
HRA Projected Year End Reserves	4,320	3,291	7,073	3,514	4,019	5,175	13,347	14,737	6,190	3,553
Total Reserves	**24,368**	**27,364**	**31,969**	**29,488**	**31,398**	**33,959**	**43,536**	**46,331**	**39,189**	**37,957**

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