APPENDIX A

Lancaster City Council

Capital Investment Strategy
2020/21 – 2024/25

1. INTRODUCTION

1.1 This strategy has been developed to cover all capital investments made by the Council particularly around regeneration, those which deliver a social return such as housing, generate an income or seek to address the climate emergency as well as operational service delivery. It covers the period 2020/21 to 2024/25 and reflects both the aspirations of Funding the Future and the Medium-Term Financial Strategy (MTFS).

1.2 The strategy is an important building block in terms of ensuring that the Council delivers the key projects which underpin its corporate priorities alongside achieving medium term financial sustainability. In reality, years of austerity and the recent pandemic have resulted in significant funding pressures and the Council's Funding the Future Strategy recognises that the Council must seek new income streams alongside greater efficiencies if it is to focus resources on delivering its corporate priorities. This strategy lessens the need to seek a balance budget through budget and subsequent service reductions.

2. THE CAPITAL INVESTMENT STRATEGY

Aim of the Strategy: Focus on Outcomes

2.1 The Capital Investment Strategy aims to provide a robust and viable framework for the deployment of capital resources in order to return positive financial returns to the Council whilst also delivering significant economic, environmental and social outcomes to improve quality of life for Lancaster district communities.

The Strategy targets the following successful outcomes:

- The development of regeneration projects including Canal Quarter and Heysham Gateway to balance financial return from development of Council owned land with providing sustainable economic development opportunities.
- The development of housing schemes which contribute to the Council's Housing Strategy and which increase the housing supply and meet local need balanced with realising opportunities to make a financial return from capital investment as well as improving environmental standards in housing.
- Acquisition of property investments which deliver a financial return to the Council both in terms of support to the revenue budget as well as capital appreciation.
- The development of green technology that contributes to the Council's Carbon Zero Strategy and makes significant contribution to the Council's 2030 zero carbon target.
- To maximise opportunities to rationalise the Council's own property portfolio in order to balance a financial return with improving the environmental efficiency of the properties.

- Taking all of the above together, to develop a Capital Programme from 2020/21 to 2024/25 that sets out an agreed annual contribution to the revenue budget and a significant impact on the Council's revenue structural budget gap.

How the Strategy will be delivered: Focus on Processes

2.2 The outcomes above will be achieved via a focus on a series of processes and procedures which ensures that projects are identified, planned and delivered having regard to best practice in terms of financial, risk, project and performance management. Specifically:

- The development of a financial plan which includes five investment streams covering the outcome areas set out in 2.1. The levels of capital investment and net income contributions will be agreed at budget setting time.

- All capital investments will be supported by business cases which set out links to corporate priorities, measurable targeted outcomes, are fully costed with details of financial returns and appropriate risk strategies. (section 4). All business cases will be subject to the scrutiny via the governance processes set out in section 9.

- Each capital scheme business case will include an outcomes schedule which will show how the project will achieve the Council's targeted priority outcomes in respect of environmental, economic and social value as well as financial yield. (section 5).

- Appropriate risk assessment and management will be incorporated into decision making with specific recognition that commercial property acquisitions have risk elements that will require thorough due diligence (section 6).

- All capital investments and associated financing will, individually and in aggregate, comply with the provision of the Prudential Code and MHCLG Investment Guidance (section 7).

- In recognition of the specialist and complex nature of capital investment, the Council will ensure that appropriate professional advice is sought as necessary and that Councillors and Officers involved in the process are provided with appropriate training. (section 8)

- Decision making processes are set out in section 9 to ensure that all capital investments are appropriately considered and authorised and are subject to scrutiny. The Governance framework sets out the roles of the Capital Strategy Group, Cabinet, Overview and Scrutiny and Council.

- A performance management framework underpins this strategy. Specifically, regular monitoring will be required for individual schemes both in respect of their financial returns as well as delivery of outcomes. Particular focus on property acquisitions both in term of yield and asset values will be undertaken alongside prudential indicators. The monitoring of the whole strategy will be essential to ensure that it is on course to deliver the incomes which contribute to balanced medium term revenue budgets. (section 10).

3. THE FINANCIAL PLAN

Investment Streams

Stream One – Economic Regeneration Opportunities

Schemes developed to provide regeneration benefits that meet the Council's inclusive and prosperous local economy priority, but which also deliver a financial return from long-term rental income, business rates and council tax growth. These schemes would seek to deliver a target net yield of **2.0%** taking account of MRP, interest, landlord and other associated costs. This stream to include rationalisation of the Council's own accommodation requirement.

The Council might enter into joint arrangements to deliver such schemes in order to share both risks and rewards and to ensure that projects can be delivered and to benefit from relevant expertise from chosen partners.

Proposals for this stream will be considered for admission into the Capital Programme Development Pool as part of the annual budget process, The projects will transfer to the full capital programme on approval by Capital Strategy Group of a full business case.

***Stream Two** – Delivery of a Social Return, for example Housing*

Schemes developed to deliver additional housing in the district which support the Council's housing strategy. Such schemes might include the development of new housing as well as purchase of existing housing with a view to making positive financial returns as well as capital gains. These schemes would seek to deliver a target net yield of **2.5%** taking account of MRP, interest, landlord and other associated costs

The Council might enter into joint arrangements to deliver housing schemes in order to share both risks and rewards and to ensure that projects can be delivered and to benefit from relevant expertise and capacity from chosen partners.

In addition to housing other examples of schemes which can provide social value include

- Investment loans to third parties
- Investing in Social Capital
- Redeveloping Council owned assets
- Using public land and buildings to achieve long-term socio-economic development within the Lancaster District

  Provision of additional, or enhanced housing within the Housing Revenue Account (HRA)

Whilst these schemes should seek to maximise financial returns, no targeted net yield will be set in the capital investment strategy. Financial returns will be considered alongside a balanced scorecard which captures quantifiable measures in respect of economic, environmental, and social returns. Where there is a negative return and costs, including capital charges and interest exceed income, this will be acknowledged as a growth pressure on the revenue budget.

Stream Three – Income Generation including Property Investments

There are six recognised types of property investment retail, industrial, hotel, office, food & beverage and other. Investment in these areas let on secure long leases to good covenants to secure a long-term income as well as capital appreciation. The Council should seek to achieve a net yield of **2.5%** taking account of MRP, interest, landlord and other associated costs.

Property investment opportunities will be considered on a regular basis by the Capital Investments Appraisal Group (CIAG) which will keep a register of opportunities. This group which is supported by expert external advice will bring forward initial proposals to the Capital Strategy Group.

The initial proposals will include:

- A financial appraisal setting out financial yields (including realistic and pessimistic scenarios)
- Risk matrix covering portfolio balance, location, tenant covenant, building quality, lease terms, tenants' repairing obligations, rent review mechanisms, occupational demand, management intensity, liquidity, tenure, environmental impact and asset management
  Outcomes matrix using balanced scorecard approach

The above matrices are included as appendices 1, 2 & 3 to this report

The CSG will consider initial proposals and determine whether its advice would be to proceed to the second stage of due diligence with a view to submitting a full proposal to Cabinet.

A quarterly report of the performance of all properties in terms of yield, income and expenditure and capital value will be included in the quarterly performance monitoring process (Delivering our Ambitions) and presented to Cabinet and Budget & Performance Panel (B&PP).

Stream Four – Carbon Zero initiatives and schemes to address the Climate Emergency

Schemes developed to deliver demonstrable reduction to carbon emissions as set out in the CZ+ Strategy as well as other priority outcomes. Schemes may include, but are not limited to:

- Installation of solar panels,
- Investment in larger scale solar energy facilities'
- Supporting agile working to reduce our carbon footprint,
- The increased electrification of our vehicle fleet

Whilst these schemes should seek to maximise financial returns, no targeted net yield will be set in the capital investment strategy. Financial returns will be considered alongside a balanced scorecard which captures quantifiable measures in respect of economic, environmental and social returns. Where there is a negative return and costs, including capital charges and interest exceed income, this will be acknowledged as a growth pressure on the revenue budget.

Stream Five – Operational Service Delivery
Schemes and projects that sustain the day to day operational delivery of the Council's services and so underpin a broad range of Council priorities. Such schemes may include upgrades or replacement of key information and communication systems. Also, Invest to Save proposals which provide short-term funding to services to help services become more efficient and effective. It likely that these schemes would be at a cost to the Council but should still be subject to a degree of scrutiny.

4. BUSINESS CASES

All capital scheme proposals will be required to comply with the Council's business case and project management protocols which requires all potential schemes to consider:

- strategic fit - how the project aligns with corporate priorities and what it is trying to achieve.
- financial – what are the financial circumstances for the project, e.g. is funding readily available and is it affordable? Reference should be made to the targets set out in the financial plan in section 3
- legislation and compliance – is the project needed to meet statutory/legislative requirements.
- risk – how the project will manage any risks identified

All capital schemes are subject to a process as part of the capital programme process which requires business cases to be compiled and assessed. Briefly, the process is in the four stages:

Stage 1 - Scoping the Scheme and Preparing the Strategic Outline Case (SOC)
The purpose of this stage is to confirm the strategic context and provide a robust case for change. This stage will consider the strategic, economic, procurement, financial and management cases and include a financial analysis taking account of the targets set out in the financial plan (section 3). Approval of the SOC will admit the project into the Capital Programme Development Pool and may release feasibility funding from reserves.

Stage 2 – Full business case (FBC)
The purpose of this this stage is to propose a viable project having taken account of any feasibility. The FBC will recommend the most economically advantageous offer, documenting the contractual arrangements, confirm funding and affordability and set out the detailed management arrangements and plans for successful delivery and post evaluation. The FBC will require approval by CSG prior to the scheme proceeding.

Stage 3 – Implementation
The business case should be used during the implementation stage as a reference point for monitoring implementation and for logging any material changes that the Council is required to make. The project will follow performance reporting protocols which will ensure that project progress, impact on outcomes and financial performance is measured throughout the project and following its completion.

Stage 4 - Evaluation
The business case and its supporting documentation should be used as the starting point for post implementation evaluation, both in terms of how well the project was delivered (project evaluation review) and whether it has delivered its projected benefits as planned (post implementation review) to the Council, in meeting strategic aims.
More information on business case compilation is available on the Programme and Project management microsite on the intranet.

An example business case proforma is included at Appendix 4 – Business Case Proforma

There are separate arrangements for the consideration of stream three investment proposals which require an assessment of financial yield, completion of a risk matrix and outcomes matrix. These are set out in more detail in section 6 and in appendices 1, 2 & 3 to this report.

5. OUTCOMES BASED MEASURES AND TARGETS

An important element of the assessment of strategic fit in the business case process is the delivery of outcomes that meet corporate priorities. The Council takes a balanced scorecard approach to identification and measuring of outcomes which seeks to capture benefits in terms of economic, social, environmental and financial measures that have been identified in the Council's corporate plan.

Each capital scheme business case will be required to set out targeted benefits which reflect those measures set out in the corporate plan.

6. RISK MANAGEMENT

Effective risk management will allow the council to adapt rapidly to change and develop innovative responses to challenges and opportunities. The risk management cycle for capital projects incorporates risk identification, risk analysis, risk control and action planning and risk monitoring and review.

All significant capital projects will comply with the Councils project management process which follows good practice in the management of risk.

A full assessment of risk will be carried out individually for each property acquisition proposal (Stream 3) before entering into any commitment and will include assessing the risk of loss. The risk assessment is an important part of the proposal process with separate consideration of each of the following factors:

- Portfolio Balance
- Location
- Tenant Covenant
- Building Quality
- Lease Term
- Tenants' Repairing Obligations
- Rent Review Mechanisms
- Occupational Demand
- Management Intensity
- Liquidity
- Tenure
- Environmental Impact
- Asset Management

The assessment and scoring of each of these risk factors will be set out in the investment proposal report and where necessary relevant external advice will be sought. A further due diligence review will be undertaken in respect of all of these risk factors for stream three investment proposals which are taken forward. The full risk matrix is set out in Appendix 3.

Whilst this strategy is not solely focused on commercial yields it must be recognised that the Lancaster City Council boundaries are relatively small and so the opportunities for certain types of investments may not be readily available. It is recommended that where possible the Council focusses its efforts on investments inside the Council boundary but where this is not possible that the investment boundary be extended to include Lancashire, Barrow and South Lakeland.

The portfolio as a whole will be risk managed through regular (quarterly) reviews of performance and annual valuations. Each asset is reviewed on an annual basis in order to review its performance, investment requirements and whether it should remain in the portfolio.

7. THE PRUDENTIAL FRAMEWORK AND INVESTMENT GUIDANCE

This strategy seeks to promote capital investments that are clearly aligned with the Council's priorities particularly around projects that provide long term support for local businesses through regeneration and those that are able to deliver a social return such as housing or to help address the climate emergency.

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

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

All capital schemes will follow the provisions of the Prudential Code, and where applicable other capital schemes such as those within Stream One, will follow the MHCLG Investment Guidance. As a minimum the following will be kept under review:

- Transparency and democratic accountability – this investment strategy will be approved by Council each year at budget setting time and any material changes will be presented to Council prior to implementation
- Contribution
- Proportionality
- Prudential Indicators
- Security
- Liquidity
- Borrowing in Advance of Need
- Capacity and Skills

A half yearly report on compliance with the prudential framework and investment guidance will be submitted for consideration by Cabinet, Budget & Performance Panel and Council.

8. CAPACITY, SKILLS AND USE OF EXTERNAL ADVISORS

The Guidance requires that elected members and officers involved in the investment decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment. In addition, it places a duty on the Council to ensure that advisors negotiating deals on behalf of the Council are aware of the core principles of the prudential framework and the regulatory regime in which the Council operates. This will be achieved by ensuring an adequate and effective training programme, obtaining appropriate advice to inform the decision making process and by ensuring that procurement arrangements provide relevant information to potential advisers of the specific principles, regulations and governance relevant to the local authority sector.

The Council will appoint specialist advisors to provide training to ensure that relevant Officers and Members have the required skills to make informed decisions and assess the associated risks. This training will take place before any investment decisions associated with the Strategy are considered and on a regular basis to ensure that Officers are engaged in continual professional development in relation to property investment activity and that Members, as decision makers, have the skills, knowledge and relevant information to effectively assist the decision making process. This will include training for new Members of the Council.

The Council recognises that investing in land and properties to achieve business objectives and to generate returns is a specialist and potentially complex area. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Where skills, or capacity are lacking, the Council will engage the services of professional property, legal and financial advisors, where appropriate, to access specialist skills and resources to inform the decision-making process associated with this Strategy. The Council measures the impact of investment decisions on borrowing and affordability through Investment Indicators to ensure that the overall risk exposure remains within acceptable levels.

9. GOVERNANCE ARRANGEMENTS

This section sets the parameters within which Capital Investment activity will take place. These parameters are designed to ensure that investments are ethical, that all risks are assessed and managed and that effective due diligence takes place in establishing the business case and that the whole process is subject to appropriate transparency and democratic accountability.

The governance framework includes the following elements:

Capital Investments Appraisal Group – an officer group with relevant expertise from economic development, property, legal and finance supported by external expertise which considers all potential capital investments in the first instance and brings forward proposals for consideration of the Capital Strategy Group.

Capital Strategy Group - constituted with representation from Cabinet, Executive, Capital Investments Appraisal Group (CIAG) and the Chairs of both Budget & Performance Panel (B&PP) and Overview & Scrutiny (O&S). CSG is a Member and Officer working group and as such is only advisory and does not have any formal decision-making authority. Following consideration of each business case it may make recommendations to budget holders in relation to due diligence costs and other matters. It may also make final recommendations to Cabinet regarding each proposal and, will determine whether projects will be admitted into the full capital programme or placed into the development pool. CSG's terms of reference are included at Appendix 5 to this strategy.

Cabinet – is responsible for submitting the Budget Framework to Council which includes this Capital Investment Strategy and capital programme. It is responsible for considering and making decision within the Budget & Policy Framework for all streams on receipt of a full business case which takes account of the due diligence and which shows compliance with the prudential code and investment guidance provisions.

Overview and Scrutiny – is represented on the CSG via the Chair's membership of this group. The early involvement of scrutiny at the pre-decision stage will allow them to add value by informing a decision rather than an after-the-event critique under the traditional process. This intention and their active involvement do not remove or negate the right to call in any decision made by Cabinet in this area.

Budget and Performance Panel – will review the financial and operational performance of this strategy as part of their budget framework scrutiny role

Council – is responsible for agreeing the Capital Investment Strategy as part of the Budget Framework each February and will be required to approve any material changes in the strategy. Council will also receive half yearly reports on the performance of the strategy.

A flowchart of the decision-making process is included in Appendix 6.

10. PERFORMANCE MANAGEMENT ARRANGEMENTS

The Investment Strategy is an important building block which provides the mechanisms for delivering the Council's corporate priority outcomes as well as contributing significantly to ensuring that the Council remains financially sustainable in the medium term. As such, the monitoring both of individual projects, particularly commercial investments, and the investment strategy as a whole will be essential to the achievement of the Council's strategic and financial objectives.

Performance monitoring will include:

- Monitoring of Capital Programme – as part of overall performance monitoring which incorporates financial, project and performance measures monitoring. Monitoring is quarterly to Cabinet and BP&P

- Financial Monitoring of Investment Strategy – as the strategy is key to reducing the medium-term budget gap, regular monitoring of the progress of the strategy will take place. This will necessarily include the delivery of investments against budgets and the yield levels against target.

- Monitoring of investments – it is acknowledged that there is risk of loss arising from property investment arising from possible impacts both on revenue income and on capital value. A regular (quarterly) report showing both the yield and income will be included in the financial monitoring to Cabinet and BP&P. The performance of individual acquisitions and the overall portfolio will be considered.

- Prudential indicators – a half yearly report on prudential indicators which aim to show that the capital programme remains prudent, affordable and sustainable will be considered by Council.