Appendix 3a: Capital Strategy 2022/23

1. Introduction

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code requires local authorities to produce a capital strategy to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and take account of stewardship, value for money, prudence, sustainability and affordability.

1.2 The Capital Strategy aligns with the priorities set out in the Council Plan and other key Council strategies. The Strategy is integrated with the Capital Programme and Treasury Management Strategy.

2. Capital Expenditure

2.1 Capital expenditure is incurred on the acquisition or creation of assets, or expenditure which enhances and adds to the life or value of an existing non-current asset that is needed to provide services. Non-current assets are tangible or intangible assets that yield benefits to the Council generally for the period of more than one year, e.g. land, buildings, roads, vehicles. This is in contrast to revenue expenditure which is spending on day to day running costs of services such as employee costs and supplies and services.

2.2 The Capital Programme is the Authority’s plan of capital works for future years, including details on the funding of the schemes. Included are projects such as the purchase of land and buildings, the construction of new buildings, design fees and the acquisition of vehicles and major items of equipment. Also included could be service and commercial investments. The Council’s Capital Programme is the subject of a separate report and will be presented to Executive with the Capital Strategy.

3. Treasury Management Investments

3.1 Treasury management investment activity covers those investments which arise from the organisation's cashflows and debt management activity, and ultimately represent balances which need to be invested until the cash is required for use in the course of business.

3.2 For treasury management investments the security and liquidity of funds are placed ahead of the investment return. The management of associated risk is set out in the Treasury Management Strategy 2022/23 which is the subject of a separate report and will be presented to Executive with the Capital Strategy.

3.3 The CIPFA Treasury Management Code recognises that organisations may make investments for policy reasons outside of normal treasury management activity. These may include service or commercial investments.

4. Service and Commercial Investments

4.1 These are investments for policy reasons outside of normal treasury management activity. These may include:

4.2 Service Investments

These are investments held clearly and explicitly in the course of the provisions and for the purposes of operational services, including regeneration.

4.3 Commercial Investments

These are investments taken for mainly financial reasons. These may include:

- Investments arising as part of business structures, such as shares and loans in subsidiaries or other outsourcing structures such as IT providers or building services providers;
- Investments taken with the aim of making a financial surplus for the Council.

Commercial investments also include non-current assets which are held primarily for financial benefit, such as investment properties.

Due to the nature of the assets or for valid service reasons, such investments do not always give priority to security and liquidity over yield. In these cases, the decision will be explicit, with the additional risks set out in the impact on financial sustainability identified and reported.

The Director of Resources will ensure that the Council has the appropriate legal powers to undertake such investments and also ensure the proportionality of all investments so that the Council does not undertake a level of investing which exposes it to an excessive level of risk compared to its financial resources.

5. Due Diligence

5.1 For all capital investments, the appropriate level of due diligence will be undertaken with the extent and depth reflecting the level of additional risk being considered. Due diligence process and procedures will include:

- identification of the risk to both the capital sums invested and the returns;
- understanding the extent and nature of any external underwriting of those risks;
- the potential impact on the financial sustainability of the Council if those risks come to fruition;
- identification of assets being held for security against debt and any prior charges on those assets;
- where necessary independent and expert advice will be sought.

The Director of Resources will ensure that Executive is adequately informed and understands the risk exposures being taken on.

6. Property Investment Strategy

6.1 The Council has a typical local authority property portfolio. This consists of operational property, investment property and property held for specific community or regeneration purposes. The Council has specific reasons for owning and retaining property:

- Operational – supporting core business and service delivery
- Investment – to provide a financial return to the Council
- Community – to support specific local community projects
- Regeneration – enabling strategic place shaping and economic growth.

6.2 The Property Investment Strategy:

- Sets out reasons for acquiring property assets for investment purposes
- Identifies the issues of the economy, the general property market and the possible risks for the Council in acquiring investment property
- Clarifies the legal powers used to operate the Strategy and ensure continued compliance
- Includes an outline of the process involved in acquiring property assets for investment purposes.

6.3 A Property Investment Strategy is a formal approach to investing in property. This is done by either buying or leasing property and ensuring that the annual income exceeds the annual lease payment or prudential borrowing repayment. The Council seeks tenants who are of sound financial standing and leases are preferable within commercially popular locations.

6.4 The Council funds the purchase of non-commercial property by borrowing money or uses the surplus of income derived from the property to meet the lease commitment. The rental income paid by the tenant must exceed the cost of repaying the borrowed money. The annual surplus then supports the Council's budget position and enables the Council to continue to provide services for local people.

6.5 The reasons for purchasing and owning property investment are primarily for:

- Financial gain to fund local services
- Market and economic opportunity
- Economic development and regeneration activity in Blackpool and the Lancashire Economic Area.

The Council does not invest in property as an Investment Strategy solely to achieve financial income.

6.6 All investment properties that cost or were previously valued at or in excess of £500k are revalued on an annual basis to provide a fair value for the preparation of the Council's accounts. The investment properties that cost or were previously valued under £500k, are valued on a rolling 4 year programme. The Council believes there is no benefit to valuations being completed within 12 months of acquisition unless a material change in the occupation or condition of the building occurs and/or the market undergoes significant change. If any investment properties valued as part of the 4 year rolling programme have changed significantly in value, an additional exercise will be carried out to assess if the cause of the material valuation change would impact on the investment assets not valued in year. Investment properties have been valued on this basis since financial year 2019/20.

6.7 The Council's Property Investment Strategy 2022/23 is attached at Appendix 3b.

7. Priorities and Risk in Property Investment

7.1 The priorities for the Council when acquiring property interests for investment purposes are:

- **Covenant Strength** - in the case of a let property, the quality of the tenant and, more importantly, their ability to pay the rent on time and in full. It is however worth noting that the Council as a public body may not wish to invest in properties where the occupiers are generally seen to be undertaking a business which is contrary to its corporate values.

- **Lease length** - in the case of a let property, the unexpired length of the term of the lease or a tenant's break clause is of key importance in ensuring that the landlord's revenue stream is uninterrupted. The Council will take into consideration the risks associated with a tenant vacating and the potential to attract good quality replacement tenants at acceptable rental levels.

- **Rate of return** - the rate of return from the property (for example through annual rental incomes) will need to be equivalent or better to the returns that could be earned from alternate investments, such as placing monies on deposit, following

adjustment for risks and potential growth. The property will also need to produce an annual return in excess of the cost of borrowing.

- **Risk** – rate of return is one side of the coin; risk is the other. In general, the higher the sought level of return from an investment, the higher level of risk that it carries. For example, if a property is let at an attractive rent which would create a good return, it could still be risky if the tenant does not possess good covenant strength and could default at any time.

- **Lease Terms** – The terms of leases vary and even those held on an "institutionally acceptable basis" can be very different in nature particularly as such leases have developed over time. The Council, where possible, will seek to invest in leases with full repairing and insuring obligations on the Tenant and a full Service Charge recovery to include any management fees. This will ensure a certain income/return to the Council.

- **Growth** - property has the potential for both revenue and capital growth. The Council will take into account that potential when assessing the strength of the investment opportunity. Property values can fall as well as rise and mechanisms to minimise revenue reductions should be identified. Generally the nature of standard, institutional leases is that rent review clauses are upward only which protects landlords from any downward pressure on rental income giving some security as to the level of income.

- **Location** - should a tenant default or vacate, the location of the property is the key factor in influencing the ability to re-let and find another tenant. Location is also important when considering future redevelopment or regeneration opportunities. Ideally the Council will be able to undertake inspections and to deal with any management issues without the need to employ specialists or agents. Preference should be given to properties located within Blackpool and the Lancashire Economic Partnership Area. This does not prevent investment outside of these areas, subject to the appropriate justification and business case and correct governance procedures.

- **Sector** - information as to the sector of use of the property (e.g. office, retail, industrial, leisure) will assist in deciding on the risks associated with specific properties and the mix of sectors within the portfolio.

- **Building Age and Specification** - in the case of a let property, whilst the Council, as an investor, may be principally concerned with the characteristics of the tenant and lease, the age and specification of the property will also affect the ability of the Council to let or sell the property in the future. It must also be taken into consideration the cost of protecting the investment. An example of this would be the undertaking of repairs and refurbishment if the cost cannot be fully recovered from the tenant.

7.2 In summary, the strategy for acquiring investment property assets is therefore to:

- Seek property let to tenants who are of strong covenant strength and sound financial standing.
- Minimise risk.
- Maximise rental income to mitigate budgetary pressures and minimise management costs to ensure the best return is generated.
- Identify opportunities for future growth, redevelopment or regeneration via property in commercially popular or development areas.
- Prioritise Blackpool and the Lancashire Economic Partnership Area if the right opportunity arises.
- Pursue opportunities to increase returns and improve the investment value of commercial assets.

7.3 The Council has invested in a number of investment property assets and lease agreements as well as a Business Loan Fund. A fair value assessment was conducted on purchase and provides sufficient security for the underlying capital invested. These assets will be revalued in line with the Council's revaluation programme.

8. Revenue Budget Implications from Capital Investment Decisions

8.1 Capital expenditure for the Council is financed through a variety of sources, typically

- Receipts from the sale of capital assets
- Capital grants
- External contributions such as S106
- The use of reserves or from revenue budget contributions.

8.2 Any capital expenditure not financed by the above will need to be funded by borrowing. Existing council debt is therefore the consequence of historical capital expenditure. The Council can temporarily utilise other resources in lieu of external borrowing to fund capital expenditure. This is referred to as internal borrowing.

8.3 In approving the inclusion of schemes and projects within the capital programme, the council ensures all of the capital and investment plans are affordable, prudent and sustainable. In doing so the council will take into account the arrangements for the repayment of debt, through a prudent Minimum Revenue Provision (MRP) policy. The Council's MRP policy is included in Annex F of the Treasury Management Strategy.

8.4 The capital financing charges and any additional running costs arising from capital investment decisions are incorporated within the annual budget and medium term financial plans. This enables Members to consider the consequences of capital investment alongside other competing priorities for revenue funding. The financing costs of prudential borrowing are charged to directorate budgets.

8.5 Capital investment decision-making is about not only ensuring the initial allocation of capital funds meets the corporate and service priorities but ensuring the asset is fully utilised, sustainable and affordable throughout its whole life. This overarching commitment to long-term affordability is a key principle in any capital investment appraisal decision. In making its

capital investment decisions the Council must have explicit regard to consider all reasonable options available.

9. Business Loans Fund

9.1 In 2009/2010 the Council set up a £3m fund for businesses to safeguard and create jobs in Blackpool during the recession. The aim of the fund is to provide a lifeline for local, normally sound businesses that are experiencing difficulty in getting finance from the banks because of the economic slowdown. A number of small unsecured loans were issued to local businesses.

9.2 As part of the 2019/20 budget process the Business Loans Fund was increased to £200m. A number of secured loans have since been issued and are treated as capital expenditure.

9.3 By issuing these loans the Council is exposing itself to the risk that the borrower defaults on repayments. The Council, in making these loans, must therefore ensure they are prudent and has fully considered the risk implications.

9.4 The Council will ensure that a full due diligence exercise is undertaken and adequate security is in place. The business case will balance the benefits with the risks. All loans are agreed as below and are subject to close, regular monitoring.

Loan Amount	Agreed by
Loans under £200,000	Chief Executive
£200,000 to £499,999	Cabinet Member
£500,000 and above	Executive

9.5 The Council makes loans, through the Business Loans Fund, for a number of reasons primarily economic development and investment objectives. Over the past 12 months, the Business Loans Fund has also provided support to local businesses through the covid pandemic on the basis of robust business plans.

9.6 The Council in making these loans mitigates associated risk by:

- Carrying out a full independent due diligence exercise
- Ongoing monitoring of the loans
- Ensuring adequate security is in place
- The financial exposure of the Council is proportionate to its size. This is currently set at £200 million.
- All loans of £500,000 and above are agreed by the Council's Executive.

9.7 The Department for Levelling Up, Housing and Communities is currently consulting on changes to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, which will affect the accounting for and impact of MRP. The Treasury Management Panel is currently reviewing the proposals and potential impacts in respect of business loans. It is unclear at this stage how these changes will affect the ability of Blackpool Council to provide these loans in the future if at all.

10. Governance Framework

10.1 It is important given the risks surrounding Growth and Regeneration Projects that the appropriate governance framework is in place hence the following processes are in place:

- The Capital Strategy to be approved annually at Full Council
- All schemes and the overall Capital Programme are subject to approval by the Executive and Full Council
- Cabinet Members are assigned projects in line with their responsibilities
- A senior officer group exists known as the Growth and Prosperity (G&P) Board which is chaired by the Director of Communications and Regeneration. The group monitors the delivery of the programme on an ongoing basis.
- Directorate Management Teams must agree all deletions and additions to their directorate capital programme before they go to Corporate Asset Management Group
- The Capital Programme is guided by the Council's Capitalisation Policy and Financial Procedure Rules of the Council
- The Capital Programme is subject to Internal and External Audit Review
- Scrutiny Committee can call in Executive Reports
- The Investment Strategy will be reviewed on a monthly basis by the Growth and Prosperity team and reported as part of the monthly budget monitoring reporting process.

11. Commercial Activity

11.1 The Council has a strong governance framework. It has a Treasury Management Panel (TMP) in addition to the usual local government audit and corporate governance committees. The Treasury Management Team is made up of leading officers from across the authority and is led by the Director of Resources as the Council's Section 151 officer.

11.2 Due diligence is of paramount importance. All of the Council's commercial investments have individual business cases that are subject to risk assessment. Where risks are identified attempts are made to mitigate and sensitivity calculations undertaken as a result. Where appropriate to the size and scale of the project the Council may also commission independent technical and legal reviews to ensure that the correct decisions are being made.

11.3 Performance monitoring takes place after the scheme is completed and is reported to Members and senior officers on an ongoing basis and is reported to Members and senior officers as part of the monthly budget monitoring process.

11.4 Audits will be carried out during the lifecycle of investments.

11.5 The Council follows a beyond prudence approach to governance of commercial activities. It ensures that all commercial schemes are fully aligned with priority outcomes.

12. Risk Appetite Statement

12.1 This outlines Blackpool Council's risk appetite with regard to its investment and commercial activities, i.e. the amount of risk that the Council is prepared to accept, tolerate or be exposed to at any point in time. It is important to note that risk will always exist in some measure and cannot be removed in its entirety.

12.2 The risk appetite statement sets out how the Council balances risk and return in pursuit of achieving its objectives. It is intended to aid careful decision-making, such that the Council takes well thought through risks to aid successful delivery of its services and obligations, while also understanding the adverse aspects of risk undertaken and taking appropriate measures to mitigate these in line with its stated goals. Thereby, the Council's risk judgements are more explicit, transparent and consistent over time.

12.3 Risk management is the process of identifying risks, evaluating their potential consequences and determining the most effective methods of managing them and/or responding to them. It is both a means of minimising the costs and disruption to the organisation caused by undesired events and of ensuring that staff understand and appreciate the element of risk in all their activities.

12.4 The aim is to reduce the frequency of adverse risk events occurring (where possible), minimise the severity of their consequences if they do occur, or to consider whether risk can be transferred to other parties. To manage financial risk effectively the risks associated with each capital project need to be systematically identified, analysed, influenced and monitored.

12.5 It is important to identify the appetite for risk by each scheme and for the capital programme as a whole, especially when investing in capital assets held primarily for financial returns. Under the CIPFA Prudential Code these are defined as investments and so the key principle of control of risk and optimising returns consistent with the level of risk applies. An assessment of risk should be built into every capital project and major risks recorded in the Risk Register.

12.6 **Credit Risk –** This is the risk that a third party the Council has invested capital monies in becomes insolvent and is unable to pay the investment returns or complete the agreed contract. Accordingly, the Council will ensure that robust due diligence procedures cover all external capital investment. Where possible contingency plans will be identified at the outset and enacted when appropriate.

12.7 **Liquidity Risk –** This is the risk that the timing of any cash inflows from a project will be delayed, for example if other organisations do not make their contributions when agreed. This is also the risk that the cash inflows will be less than expected, for example due to the effects of inflation, interest rates or exchange rates. The Council's

exposure to this risk will be monitored via the revenue and capital budget monitoring processes. Where possible appropriate interventions will occur as early as possible.

12.8 **Interest Rate Risk –** This is the risk that interest rates will move in a way that has an adverse effect on the value of capital expenditure or expected financial returns from a project. Interest rates will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

12.9 **Exchange Rate Risk –** This is the risk that exchange rates will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Where relevant, exchange rates will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

12.10 **Inflation Risk –** This is the risk that rates of inflation will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Rates of inflation will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible the Council's exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

12.11 **Legal and Regulatory Risk –** This is the risk that changes in laws or regulation make a capital project more expensive or time consuming to complete, make it no longer cost effective or make it illegal or not advisable to complete. Before entering into capital expenditure or making capital investments, the Council will understand the powers under which the investment is made. Forthcoming changes to relevant laws and regulations will be kept under review and factored into any capital bidding and programme monitoring processes.

12.12 **Fraud, Error and Corruption –** This is the risk that financial losses will occur due to errors or fraudulent or corrupt activities. Officers involved in any of the processes around capital expenditure or funding are required to follow the Council's policies and procedures. This is supported by the Employee Code of Conduct and policies such as Anti-Fraud and Corruption, Anti Money Laundering and Declaration of Interests.

12.13 Risk management is not a stand-alone discipline. In order to maximize risk management benefits and opportunities, it is integrated with existing business processes.

12.14 Some of the key business processes with which risk alignment exists are:

- Capital Strategy
- Medium-Term Financial Plan
- Internal Audit
- Business Planning (including budget)

- Performance Management
- Treasury Management
- Council-owned subsidiaries and joint ventures
- External Audit review

13. Knowledge and Skills

13.1 The Capital Programme and Treasury Management Strategy are managed by a team of professionally qualified accountants with extensive local government finance experience between them. They follow a Continuous Professional Development Plan (CPD) and attend courses on a regular basis to keep abreast of new developments and skills. The Council's Section 151 Officer is the officer with overall responsibility for Capital and Treasury activities and is also a professionally qualified accountant and follows an ongoing CPD programme.

13.2 All the Council's commercial projects have project teams from all the professional disciplines across the Council as and when required. External professional advice is taken where required and usually sought in consideration of any major commercial property investment decision.

13.3 Internal and external training is offered to Members on an annual basis to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions.

13.4 The Council's Treasury Management Panel (senior officer group) reviews all commercial and investment deals from inception right through to project completion and ongoing performance management.

14. Treasury Management

14.1 The Council also produces a Treasury Management Strategy which is approved by Full Council annually as part of the budget setting process.

14.2 There are close links between the Capital Strategy, Capital Programme and Treasury Management Strategy. The capital programme determines the borrowing need of the Council, essentially the longer term cashflow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cashflow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

14.3 At the end of 2024/2025 it is forecast that the Council's long-term debt will be £96.667m.

14.4 The Council's Authorised limit for 2022/23 is £588m and represents a limit beyond which external debt is prohibited, this limit needs to be set or revised by the Full Council.

14.5 The Council's Operational Boundary debt forecast for 2022/23 is £578m. This represents the limit beyond which external debt is not normally expected to exceed.

14.6 The Council makes provision for the repayment of debt over the life of the asset that the borrowing is funding. Over the period 2022/2023 – 2024/2025 the Council is forecast to make a provision of £27.66m for the repayment of debt. The bulk of Council borrowing is linked to the Business Loans Fund and Economic Regeneration Schemes, which generate a financial return to the Council above the borrowing cost and a number of the schemes are asset-backed.

14.7 The Council follows the requirements of The Local Government Act 2003 (the Act) and supporting regulations in managing its treasury management activities.

14.8 The Executive is the body responsible for the governance of Treasury Management within the Council. It recommends an annual Treasury Management Strategy to Full Council for approval as part of the annual approval of the Budget. It also receives a half-year review report and the annual Treasury Management outturn report.

14.9 The Treasury Management Panel, which comprises the Director of Resources, Finance Manager and representatives from Corporate Finance and Blackpool Coastal Housing, has responsibility for managing the risks associated with treasury management activities on an operational basis.

14.10 Treasury Management is also subject to regular Internal and External Audit reviews.

15. Liability Benchmark

15.1 The Prudential Code requires the production of a liability benchmark which is shown in the following graph. The liability benchmark is the level of expected debt given current projections for capital expenditure up to year 2024/25. The projected debt levels show what the Council expects its debt level to be. Where the debt level is below the benchmark, the Council will be in an under-borrowed position and when it is above it will be over-borrowed. This makes assumptions regarding repayment dates and can be used as a tool for scheduling future borrowing requirements.