

## Bath and North East Somerset Capital and Investment Strategy 2024/25

### Introduction

The Government introduced a new requirement in 2019/20 for local authorities to approve a Capital and Investment Strategy. The strategy is the overarching document which sets the policy framework for the development, management and monitoring of capital investments as well as lending to other organisations and commercial investments. The strategy focuses on core principles that underpin, and also outlines the governance framework required for, decision making and delivery.

The capital and investment strategy aligns with the principles set out in the Council's Corporate Strategy of:-

- Preparing for the future;
- Delivering for local residents;
- Focussing on prevention

The strategy is integrated with the Medium-Term Financial Strategy and Treasury Management Strategy.

### Capital Expenditure

Capital expenditure occurs when the Council spends money on assets, such as land, property or vehicles that have a life of more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies to enable them to buy assets. The Council has limited discretion on what can be accounted for as capital expenditure, and this is outlined through its Accounting Policies which are updated and published annually as part of the Statement of Accounts.

The Council's planned capital expenditure over the 5-year period covering 2024/25 to 2028/29 is as follows:

	<b>2024/25 Budget</b>	<b>2025/26 Budget</b>	<b>2026/27 Budget</b>	<b>2027/28 Budget</b>	<b>2028/29 Budget</b>
	£'m	£'m	£'m	£'m	£'m
<b>Total</b>	<b>152.949</b>	<b>90.698</b>	<b>57.640</b>	<b>55.113</b>	<b>29.636</b>

Full details of new Capital Schemes over the 5 year period are outlined in Annex 5 of the budget report.

As part of the approval process Directors submit Needs Assessments for consideration to the Capital Strategy Group. These are then prioritised within the available capital financing available. Given the current constraints on local authority

finances the following process and principles are used for the current programme as well as new schemes.

For the 2024/25 budget a gateway has been applied for all new capital programme items that set out the following:

1. Scheme name and purpose
2. Scheme funding
3. Why is the scheme required
4. Corporate strategy outcomes achieved

Prioritisation is applied to the programme where borrowing is required to fund the scheme:

Priority 1: The scheme is addressing a structural maintenance issues / legal compliance and health and safety risk to the Council and its residents.

Priority 2: The scheme will improve the affordability and delivery of Council services to its residents.

Priority 3: The scheme will create a new asset that will add to the community and Council aspirations, however not essential to the delivery of its statutory responsibilities.

Bids are reviewed by the Finance team and funding streams such as Service Supported Borrowing, Corporate Supported Borrowing, S106, CIL, WECA, capital receipts, or external grant are assessed. Portfolio Holders review the overall bids to agree priorities and overall affordability. As part of the budget process the bids are linked to the Corporate Strategy Principles and reviewed by the Capital Strategy Group before putting forward for consideration in the budget. The final capital programme is then presented to Council in February each year for approval. The Council's Capital Programme can be found at Annex 5.

Schemes can either be classified as **Fully Approved or Provisionally Approved**. Items gaining **Full Approval** are clear to proceed to full scheme implementation and delivery, subject to appropriate project management and governance.

Items for **Provisional Approval** will require either a further Officer decision and in some cases a formal Cabinet member decision for Full Approval. The budget estimates for schemes shown for Provisional Approval are therefore included on an indicative basis, and as an aid to planning.

The Capital Programme will retain narrative only reference to pipeline projects and grant funding in an early stage of progression. These items will require further decision to incorporate them into the programme once finalised.

### **Financing the Capital programme**

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 Section 106 planning obligations or Community Infrastructure Levy
- The use of reserves or from revenue budget contributions

Any capital expenditure not financed by the above means 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.

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 MRP policy in line with MRP guidance produced by the Department for Levelling Up, Housing and Communities.

The capital financing charges and any additional running costs arising from capital investment decisions are incorporated within the annual budget and Medium Term Financial Strategy. This enables members to consider the consequences of capital investment alongside other competing priorities for revenue funding.

Borrowing costs are allocated as either Service Supported Borrowing where the service can demonstrate that it can fund the costs of borrowing from their individual budgets or Corporate Supported Borrowing where the costs are financed centrally.

Financing of the revised capital programme is shown below:-

<b>Source of Finance</b>	<b>2023/24 Budget</b>	<b>2024/25 Budget</b>	<b>2025/26 Budget</b>	<b>2026/27 Budget</b>	<b>2027/28 Budget</b>
	£'m	£'m	£'m	£'m	£'m
Grant	52.856	40.166	15.828	8.812	8.489
Capital Receipts /RTB	11.183	0.994	1.000	0	0
Revenue	3.878	0.02	0.040	0.02	0.020
Borrowing	77.315	46.028	38.583	43.294	20.124
3rd Party (inc S106 & CIL)	7.717	3.490	2.189	2.987	1.003
<b>Total</b>	<b>152.949</b>	<b>90.698</b>	<b>57.640</b>	<b>55.113</b>	<b>29.636</b>

## Links to Treasury Management

One of the key aims of Treasury management is to retain sufficient but not excessive cash to meet the Council's spending needs, while managing the risks involved.

The Council is continuing with an agreed strategy of utilising its cash balances rather than incurring the higher cost of long-term borrowing at present. The strategy can be demonstrated through the CFR at the end of 2022/23 which was £341.0m which outlines the Council's underlying need to borrow compared to the current actual long-term borrowing of £216.0m as at 31<sup>st</sup> December 2023.

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Section 151 Officer and his/her team, who must act in line with the Treasury Management Strategy approved by Council. Quarterly reports on treasury management activity are presented to the Cabinet. The Corporate Audit Committee is responsible for scrutinising treasury management decisions.

## Loans

The council has discretion to make loans for a number of reasons, primarily for housing, economic development, and renewable energy. Current loans include:-

*Table 1: Loans for service purposes in £ millions*

<b>Loan Detail</b>	<b>Amount Outstanding at 31st March 2021</b>	<b>Amount Outstanding at 31st March 2022</b>	<b>Amount Outstanding at 31st March 2023</b>
	<b>£'m</b>	<b>£'m</b>	<b>£'m</b>
Council's Housing Company	11.167	9.491	5.973
Bath & West Community Energy - Renewable Energy Scheme	0.101	0.094	0.086
<b>Total</b>	<b>11.269</b>	<b>9.585</b>	<b>6.060</b>

These loans are treated as capital expenditure. In making 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, with regard to both the individual loan and that the cumulative exposure of the council is proportionate and prudent.

The council will continue to ensure that a full due diligence exercise is undertaken and adequate security is in place. The business case will balance the benefits and risks. All loans are either agreed by Cabinet or specific delegated authority. All loans will be subject to close, regular monitoring.

## Shares

The Council holds nominal shares in its own wholly owned company Aequus Group Holdings Ltd.

## Asset Management

The overriding objective of asset management within the council is to achieve a corporate portfolio of property assets that is appropriate, fit for purpose and affordable. The council's property portfolio 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 purposes e.g. assets that support core business and service delivery e.g. schools, office buildings.
- Non-operational purposes including Investment properties held to provide a financial return to the council that support service provision (the Commercial Estate).
- Parks, playgrounds and open spaces.
- Regeneration, enabling strategic place shaping and economic growth.

During 2023/24 and into 2024/25 the Council is implementing a Corporate Landlord Model for the management of the Council's Corporate Estate alongside a dedicated Commercial Estates function for the running of the investment assets.

The vision statements for the functions are below:

<b>Corporate Landlord Mission</b>	
<i>"To excel in the management of a significant portfolio and to be an exemplar landlord by proactively challenging our assets to deliver the best for B&amp;NES and its residents whilst delivering a resilient net income that supports the wider objectives of the Council"</i>	
<b>Corporate Estate Team Vision</b>	<b>Commercial Estate Team Vision</b>
<i>"To deliver all Council objectives in a transparent, safe, and compliant manner through the management of an efficient, sustainable, and valuable asset portfolio with centralised governance."</i>	<i>"To support the Council's corporate, and budgetary objectives, through the generation of resilient net income"</i>

Asset management is an important part of the council's internal business management arrangements and is crucial to the delivery of efficient and effective services. The ongoing management and maintenance of capital assets will be considered as part of the Medium-Term Financial Strategy. The Capital Programme also includes the following for capital works on Council owned properties:

- Corporate Estate – planned capital maintenance £5.5m in 2024/25 and £3m per annum in future years.
- Commercial Estate refurbishment programme £7.0m in 2024/25 and £1.5m per annum in future years.
- Commercial Estate Planned Maintenance Programme £0.5m in 2024/25 and £0.5m per annum in future years.
- Commercial Asset Re-investment £5m in 2024/25, £2m 2025/26 & 2026/27 and £3m per annum thereafter.

The property portfolio is continually reviewed for disposal or where appropriate development by the Council's wholly owned companies Aequus Developments Ltd and Aequus Construction Ltd.

### **Commercial Activities**

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines investment property as property held solely to earn rentals or for capital appreciation or both. Returns from property ownership can be both income driven (through the receipt of rent) and by way of appreciation of the underlying asset value (capital growth). The previous strategy has considered investment through new commercial asset acquisition. Under changes published by the Treasury's Public Works and Loan Board (PWLB) in November 2020, borrowing will no longer be made available to Council's undertaking debt for yield acquisitions.

In the context of the Capital and Investment Strategy, the Council will need to consider how it makes best use of its current asset base to sustain the existing budget income levels and support the Councils financial recovery from the Covid pandemic. This may require commercial investment to support the repurposing and regeneration of our economy and to diversify and sustain pre-Covid commercial income levels through the asset we hold.

The reasons for taking out borrowing / providing capital for property investments are primarily:-

- To sustain existing financial return to fund services to residents

- Market and economic opportunity to repurpose and diversify the Commercial and Corporate Estate.
- Economic development and regeneration within B&NES

Historically, property has provided strong investment returns in terms of capital growth and the generation of stable income, however this is now under significant risk due to Covid and market uncertainty. The retail sector and trends towards internet shopping is a factor but also the office sector with remote working practices firmly embedded in business culture. As with all investments, property as an investment medium, is not without risk: property values can fall as well as rise. Changing economic conditions could cause tenants to leave with properties remaining vacant which not only reduces revenue income but in itself incurs additional holding costs such as maintenance and business rates.

The Council currently has 264 properties held for investment purposes as shown in the table below, the additional new build property of Bath Quays South Offices having reached practical completion in 2022/23. The revenue income supports Council frontline services including Adult and Children's Social Care Services.

*Table 2: Property held for investment purposes in £ millions*

<b>Property Type</b>	<b>No of Properties as at 31/3/22</b>	<b>Value in Accounts as at 31/3/22</b>	<b>No of Properties as at 31/3/23</b>	<b>Value in Accounts as at 31/3/23</b>
	<b>No.</b>	<b>£'m</b>	<b>No.</b>	<b>£'m</b>
Retail	189	174.517	189	162.589
Offices	12	21.41	13	37.85
Licensed	20	19.029	20	17.905
Industrial	17	18.693	17	16.751
Other	22	16.121	22	13.928
Leisure	3	7.323	3	7.362
<b>Total</b>	<b>263</b>	<b>257.093</b>	<b>264</b>	<b>256.385</b>

A fair value assessment of the Authority's investment property portfolio is made every twelve months, this is reported in the year end accounts. An investment strategy and asset management plan is prepared that details at an operational level the Council's approach to holding and acquiring assets, however, by necessity such documents have to be reviewed on a frequent basis to take account of such government guidance, prevailing market conditions and other risks and uncertainty. This is particularly relevant in view of the impact of Covid-19 and variants.

For any organisation the underlying value of its assets can provide security against its borrowings. The Authority assesses the risk of loss when considering its property

investments through appropriate due diligence and works closely with external commercial property advisors where appropriate.

Advice has previously been sought on the appropriate level of gearing for the portfolio and how this should be benchmarked. It is believed that staying within an agreed gearing ratio should ensure the Council's portfolio is protected from the risk of fluctuations in the rates of borrowing.

New investment, which is influenced by Government guidance, will continue to be supported by a Business Case detailing how the proposal fits the Council's investment criteria, any associated risks and how these can be mitigated.

The Council will continue to invest prudently within the B&NES area to take advantage of opportunities as they present themselves, supported by a robust governance process.

The Council will consider new investment on the grounds of regeneration of the wider portfolio and the actions required to diversify and sustain existing budget income levels. Any new investment will review the structural and risk implications of developing the existing portfolio.

### **Proportionality**

The Authority dependency on investment activity to deliver services is shown below:-

*Table 3: Proportionality of Investments*

	<b>2020/21 Actual</b>	<b>2021/22 Actual</b>	<b>2022/23 Actual</b>	<b>2023/24 Forecast</b>
	<b>£'m</b>	<b>£'m</b>	<b>£'m</b>	<b>£'m</b>
Net Council Revenue Expenditure	105.462	125.291	131.934	137.341
Gross Income from Investment Properties	11.165	16.965	15.694	16.636
Gross Income from Treasury Investments	0.332	0.311	1.559	1.760
<b>Proportion of Investment Income to Net Revenue Expenditure</b>	<b>10.90%</b>	<b>13.79%</b>	<b>13.08%</b>	<b>13.39%</b>

*The proportion is all investment income divided by the gross service expenditure*

If budgeted income is lower or budgeted expenditure is higher than expected the Authority holds a Revenue Budget Contingency and Un-Earmarked Reserves to meet any in-year shortfalls. If a shortfall were to continue into the medium to longer term a pressure would be added to the Medium Term Financial Plan that would have to be found from other sources either additional income elsewhere or cuts to services.



### **Borrowing in Advance of Need**

New Government guidance in 2018 outlined that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority has previously borrowed for this purpose because the acquisitions have enabled the council to vary its portfolio mix to increase diversification from retail.

In line with the Council's financial planning the income continues to be utilised to protect frontline services, including the provision of adult social care; children and environmental services pursuant to the Council's general power of competence under s.1 Localism Act 2011.

The previous acquisitions of the properties were in pursuance of the benefits (and in particular those of an economic nature) that it conferred upon the Council and its area, in accordance with s120 of the Local Government Act 1972. The acquisitions aligned themselves with the Council's Investment Strategy for the Commercial Estate that was in place at that time.

Business cases are assessed using the prevailing long-term PWLB borrowing rate. Changes in interest rates are carefully monitored and managed through Treasury Management. A Capital Financing Reserve is held to manage any in year additional borrowing costs. Income from the commercial estate is monitored monthly and the Council holds a Revenue Budget Contingency and Un-earmarked balances to meet with in-year shortfalls. Ongoing shortfalls would be reflected in the MTFS as well as a review of whether individual properties should be held or sold.

### **Provision for Risks Capital Bids**

Each capital bid is risk assessed and a reasonable contingency sum is allocated within the project budget. In addition to this the Council sets aside a sum each year as a Capital Contingency as part of setting the budget to meet risks that require additional capital financing within the financial year. It also retains a revenue reserve to meet any unforeseen or additional revenue requirements such as additional interest or revenue reversion risks that require additional financing.

### **Knowledge and Skills**

The council has professionally qualified staff across a range of disciplines including finance, legal and property that follow continuous professional development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills.

The council establishes project teams from all the professional disciplines from across the council as and when required. External professional advice is taken where required and will always be sought in consideration of any major commercial property investment decision.

### **Investment Indicators**

The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

The following indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

*Table 4: Total investment exposure in £millions*

<b>Total Investment Exposure</b>	<b>31/3/21 Actual</b>	<b>31/3/22 Actual</b>	<b>31/3/23 Actual</b>
	<b>£'m</b>	<b>£'m</b>	<b>£'m</b>
Treasury Management Investments	67.500	84.200	42.300
Service Investments Loans	11.269	9.585	6.060
<b>Commercial Investments - property</b>	<b>260.915</b>	<b>257.093</b>	<b>256.385</b>
<b>Total Investments</b>	<b>339.684</b>	<b>350.878</b>	<b>304.745</b>
Contractual Commitments to Lend	0	0	0
Guarantees Issued on Loans	0	0	0
<b>Total Exposure</b>	<b>339.684</b>	<b>350.878</b>	<b>304.745</b>

Current Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, commercial investment properties acquisitions shown in table 4 can be linked to the borrowing shown in the following table 5. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure through Treasury Management:

*Table 5: Investments funded by borrowing in £millions*

<b>Investments Funded by Borrowing</b>	<b>2020/21 Actual</b>	<b>2021/22 Actual</b>	<b>2022/23 Actual</b>
	<b>£'m</b>	<b>£'m</b>	<b>£'m</b>
Commercial Investments – Property	93.258	93.274	93.341

- Includes Bath Quays South Offices which became operational in 2022/23.

The following indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred:

*Table 6: Investment rate of return (net of all costs)*

<b>Investments net rate of return</b>	<b>2021/22 Actual or Average Value/ Investment</b>	<b>2021/22 Actual Return</b>	<b>Rate of Return</b>	<b>2022/23 Actual or Average Value/ Investment</b>	<b>2022/23 Actual Return</b>	<b>Rate of Return</b>
	<b>£'m</b>	<b>£'m</b>	<b>%</b>	<b>£'m</b>	<b>£'m</b>	<b>%</b>
Treasury Management Investments (weighted average balance)	86.167	0.311	0.36	74.600	1.559	2.09
Service Investments: Loans (weighted average balance)	10.093	0.297	2.94	7.134	0.156	2.19
Commercial Investments: Returns on Property Compared to Income	257.093	15.388	5.99	256.385	14.003	5.46

*Other investment indicators*

	<b>2020/21 Actual</b>	<b>2021/22 Actual</b>	<b>2022/23 Actual</b>	<b>2023/24 Forecast</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
<i>Debt Interest Payments to net revenue expenditure</i>	7.43	5.96	5.52	6.34
<i>Debt Financing Costs (Interest &amp; MRP) to net revenue expenditure</i>	13.97	12.63	12.47	13.76
Commercial Investments debt compared to asset value	35.74	36.28	36.41	35.99
Net commercial income compared to net Council expenditure	9.69	12.28	10.61	11.03