

DRAFT CAPITAL STRATEGY

Financial Years 2019/20 to 2023-24

INTRODUCTION AND BACKGROUND

1. This Capital Strategy is an overarching document which sets the policy framework for the development, management and monitoring of capital investment. The strategy focuses on core principles that underpin the City Corporation's capital programme. In particular it covers:
 - the short, medium and longer-term objectives;
 - the key issues and risks that will impact on the delivery of the programme;
 - and the governance framework in place to ensure the capital programme is delivered and provides value for money.
2. This capital strategy aligns with the priorities set out in the City Corporation's Corporate Plan and other key strategy documents such as those covering the investment estates.
3. The strategy is integrated with the medium-term financial plan and treasury management strategy.
4. The Court of Common Council will agree the capital strategy and programme at least annually and as necessary in the event of a significant change in circumstances.

CORE PRINCIPLES THAT UNDERPIN THE CAPITAL PROGRAMME

5. The key principles for the capital programme are summarised below and shown in more detail as Annex A.
6. Capital investment decisions reflect the aspirations and priorities included within the City Corporation's Corporate Plan and supporting strategies.
7. Schemes to be added to the capital programme will be subject to a gateway process overseen by Project Sub Committee. The only exceptions to this are for the major projects that are dealt with by Capital Buildings Committee and Policy and Resources Committee and investment property acquisitions and disposals which are overseen by Property Investment Board. All schemes are prioritised according to availability of resources and scheme specific funding, and factors such as legal obligations, health and safety considerations and their longer-term impact on the City Corporation's financial position.
8. A key consideration is affordability of the capital programme in terms of the City's Medium Term Financial Plan. In any programme presented to Members for agreement this issue will have been considered and, where resources are limited, new bids must be prioritised to ensure the best use of available funds.

9. Commissioning and procuring for capital schemes will comply with the requirements set out in the City Corporation's Standing Orders, Financial Regulations and Procurement Code.

GOVERNANCE FRAMEWORK

10. The City Corporation in its local authority capacity is required to agree the capital strategy annually in accordance with the Prudential Code. To be consistent with the City Corporation's Treasury Management Strategy Statement the capital strategy for City's Cash is being reported on the same basis. For the time being, capital plans of the Bridge House Estates Trust are excluded pending the outcome of the Bridge House Estates Governance review, although the general principles and framework described in this document will apply.
11. The impact of the capital programmes for each fund is incorporated into the medium-term financial plans to demonstrate affordability, sustainability and prudence.
12. To assist in the resource allocation process, project proposals are prioritised and categorised, with only essential schemes within the following criteria being considered for central funding:
 - health and safety or statutory requirements,
 - substantially reimbursable
 - spend to save (payback within 5 years)
 - income generating
 - major renewals of income generating assets.

Due to the large volume of pipeline schemes, a more stringent set of criteria are being developed to assist Policy & Resources Committee to decide whether resources should be allocated.

13. Projects are one of the key ways that the City Corporation delivers its strategic aims and priorities. The City Corporation is committed to ensuring that projects are delivered efficiently and that the best use is made of the resources available to the organisation. Approval of projects is the responsibility of the Policy and Resources Committee through its Projects Sub-Committee, which scrutinises individual projects, and the Resource Allocation Sub-Committee, which considers the overall programme of project activity and its funding. Decisions about projects are made in conjunction with service committees and the Court of Common Council (for high value projects). Major Projects are managed directly through the Capital Buildings or Policy and Resources Committees.
14. Where the Town Clerk considers a scheme has policy implications, or where the Policy and Resources Committee has indicated it wishes to consider a particular project further, project reports will also be submitted to that Committee.
15. The Finance Committee is responsible for obtaining value for money, improving efficiency and overseeing procurement generally across the organisation. The

Finance Committee therefore receives periodic reports on the City Corporation's capital expenditure.

16. The gateway process is contained in the Project Procedure, which is approved by the Policy and Resources Committee and the Court of Common Council. It applies to capital projects over £50,000. The Town Clerk monitors the progress of reports from start to finish and project managers maintain information about the progress of projects on the Project Vision system. Project Boards are usually established for individual projects, particularly those that require officers from a number of departments to deliver them.
17. Inclusion of schemes in the capital programme is subject to agreement by the relevant City Corporation committees which, depending on value, will include the Court of Common Council.
18. All projects included in the capital programme must comply with standing orders, financial regulations, the project procedure, the procurement code and rules and are subject to confirmation of funding.

SHORT, MEDIUM AND LONGER-TERM CAPITAL PLANNING OBJECTIVES

19. The City Corporation maintains an approved capital programme that covers a five-year period which is approved by the Court of Common Council as part of the annual budget setting process.
20. Going forward the plan is to extend the capital programme over a longer term, especially with regard to the major projects, to aid in the financial planning process. Planning the capital programme over a ten-year period will ensure that the City Corporation does not over-commit to a capital programme that is not affordable, sustainable and prudent.
21. The impact of the major projects on available funding over the medium to long term will be significant and it will be a requirement to prioritise the remaining capital spend to make best use of the limited resources that will be available.
22. The City Corporation has substantial operational property and investment property portfolios. Strategic plans are produced for each fund for the investment properties which are agreed by Property Investment Board. Operational properties are overseen by Corporate Asset Sub Committee with a corporate asset management plan being overseen by this committee.
23. Such a sizeable property portfolio requires significant capital and revenue investment to maintain it and, in the case of the investment property, maximise the returns. These schemes are therefore likely to make ongoing major calls on the City Corporation's limited capital resources.
24. To assist with managing this commitment the City Corporation is conducting an operational property review with a view to disposing surplus assets through rationalising the operational property estate.

CAPITAL INVESTMENT PRIORITIES

25. Capital investment plans are driven by the City Corporation's Corporate Plan, the key strategic document that sets out the City Corporation's vision, ambitions, values and priorities. The Corporate Plan is underpinned through the departmental business plans which include assets required in their delivery and highlight capital investment requirements and aspirations. The latest draft capital plans, which include the indicative cost of schemes still under development, are as follows:

	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m	Later years £m	Total £m
City Fund	117	211	183	286	210	460	1,541.2
City's Cash	201	174	156	139	81	881	1,695.7
Bridge House Estates							120.4
	318	385	339	425	291	1,341	3,357.3

The draft plans have been further analysed into three main groups:

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m
Major Projects	950.9	1,365.1	-	2,316.0
Capital and SRP Programmes	365.3	180.1	120.4	665.8
Pipeline/Funding Unconfirmed	225.0	150.5	-	375.5
TOTAL:	1,541.2	1,695.7	120.4	3,357.3

26. There are four major projects at various stages of development:

- Museum of London Relocation (City Fund and City's Cash)
- Combined Courts (City Fund)
- Market Consolidation Programme (City's Cash)
- Centre for Music (City's Cash, largely beyond the medium-term financial planning period)

27. These projects represent a substantial funding requirement of unprecedented scale in the context of the City Corporation's more recent capital plans. They therefore present a significant challenge to the finances of the organisation, requiring a step change in the previously debt-free status of both City Fund and City's Cash.

28. Other significant commitments within the current capital programme include:

- Investment Property refurbishments
- Infrastructure improvements at the Old Bailey
- Guildhall Complex new acquisition and refurbishment
- Social Housing Decent Homes refurbishments and new affordable housing units

29. Pipeline schemes include:

- City of London Schools Improvement Programmes (cash flow financing)
- Major refurbishment works to the Guildhall Complex

- Highways and Public Realm improvements
- IT modernisation and transformation

30. More stringent criteria are being developed to assist Policy & Resources Committee to decide resource allocation for these unfunded schemes. This may result in some schemes being cancelled or deferred.

ASSET MANAGEMENT PLANNING

31. The overriding objective of asset management within the City Corporation is to achieve a corporate portfolio of property assets that is appropriate, fit for purpose and affordable.

32. The City Corporation's property portfolio consists of both operational and investment property. The City Corporation has specific reasons for owning and retaining property:

- Operational purposes e.g. assets that support core business and service delivery such as schools, office buildings, The Barbican Arts Centre, Central Criminal Court, cleansing depot, cemetery and crematorium, port health offices, markets, Mansion House and open spaces across London.
- Investment properties held to provide a financial return to the City Corporation to provide financial support for service provision.
- Strategic investment to enable growth in the City fringe - the strategic property estate.

33. Asset management is an important part of the City Corporation's business management arrangements and is crucial to the delivery of efficient and effective services. The ongoing management and maintenance of operational property assets is considered as part of the Corporate Asset Management Strategy. The asset management planning includes an objective to optimise the City Corporation's operational estate.

34. The development of Asset Management Plans across the operational estate assists in delivering the asset management component of service department business plans. In so doing, these plans support the prioritisation of future capital requirements and incorporation of corporate objectives across the operational estate.

35. There is a strong link between Asset Management Plans and the Asset Management Service Based Review, which seeks to improve asset management processes and deliver future efficiencies. Recommendations from this review have now received committee approval and will support improvements to financial sustainability, corporate policies and controls, data management, strategic asset planning, delivering asset management related projects, compliance and property management process.

COMMERCIAL ACTIVITY AND INVESTMENT PROPERTY

36. 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.
37. Returns from our investment property ownership can be both income-driven (through the receipt of rent) and by way of appreciation of the underlying asset value (capital growth).
38. The combination of these is a consideration in assessing the attractiveness of a property for acquisition. In the context of the Capital Strategy, the City Corporation uses capital to invest in property to provide a positive surplus/financial return which is a key source of funding for the ongoing provision of services.
39. Property investment is not without risk as property values can fall as well as rise and changing economic conditions could cause tenants to leave with properties remaining vacant. These risks are mitigated in part by the mixed lease structure of holdings with some properties directly managed with multiple lettings, some single lettings to tenants on fully repairing and insuring leases and some to tenants on geared ground rent leases where the City Corporation is guaranteed a minimum rent but also shares in the actual rent received over a certain threshold.
40. The property portfolio is overseen by Members through a dedicated Property Investment Board appointed by Investment Committee which meets on a monthly basis to receive reports on performance, set strategy, and agree major lettings, acquisitions and disposals.
41. Performance of each estate is benchmarked through MSCI against the overall MSCI Universe and against the MSCI "Greater London Properties including owner occupied" benchmarks. The target set is to outperform the MSCI benchmarks for Total Return on an annualised five-year basis. There is also a subsidiary target to maintain rental income levels and to endeavour to secure rental income growth at least in line with inflation.
42. The properties forming the Strategic Property Estate have been acquired for large scale redevelopment. They are part of the strategy of supporting growth in the business cluster in the City Fringes by providing high quality floor space and returns from these properties are focussed on capital appreciation through their redevelopment.
43. The Property Investment Board receives quarterly rent five-year rental forecast reports and regular reports on the level of voids and debtor arrears. From time to time the Board also receives presentations, usually from major firms of surveyors, on the state of the UK and London property market and potential future trends.

REVENUE BUDGET IMPLICATIONS FROM CAPITAL INVESTMENT DECISIONS

44. Capital expenditure for the City Corporation is financed through a variety of sources, typically
- Receipts from the sale of capital assets
 - Capital grants

- External contributions such as S106 or Community Infrastructure Levy
- The use of general reserves or from revenue budget contributions
- Earmarked reserves set aside for specific purposes.

Any capital expenditure not financed from the above sources will need to be funded by prudential borrowing, which can either be internal or external.

45. The City Corporation can utilise its temporary cash balances in lieu of external borrowing to fund capital expenditure. This is referred to as internal borrowing. External borrowing refers to loans from third parties e.g. banks or the Public Works Loans Board.
46. To date, the City Corporation has funded all of its capital expenditure from the sources listed above or through internal borrowing. Going forward the impact of the major projects means that external borrowing will be required.
47. In approving the inclusion of schemes and projects within the capital programme, the City Corporation ensures all of the capital and investment plans are affordable, prudent and sustainable. In doing so the City Corporation will take into account the arrangements for the repayment of debt, through a prudent Minimum Revenue Provision (MRP) policy in line with MRP guidance produced by the Ministry of Housing, Communities and Local Government.
48. The capital financing costs 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.
49. As part of the appraisal process, and at the discretion of the Chamberlain, the financing costs of prudential borrowing, may be charged to the relevant service.
50. Capital investment decision making is not only about ensuring that the initial allocation of capital funds meets 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 and is particularly challenging in relation to the four Major Projects. In making its capital investment decisions the City Corporation must have explicit regard to consider all reasonable options available.
51. The revenue implications of the major projects are significant. The cost of borrowing must be charged to the relevant revenue budget whether this is on an interest-only or repayment basis. The long-term nature of borrowing means these revenue sums are unavailable to fund other activity for a significant period of time. By agreeing to fund capital schemes through borrowing, Members are agreeing to divert this funding away from revenue activity in order to meet their priorities.
52. The City Corporation must ensure that a MRP is set aside for all City Fund related borrowing. This is managed by borrowing on an annuity basis for long term borrowing which repays the capital and interest over the term of the borrowing. The MRP is aligned to the interest repaid over the term of the loan.

RISK MANAGEMENT

53. This section considers the City Corporation's risk appetite with regard to its capital investments and commercial activities, i.e. the amount of risk that the City Corporation 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.
54. A risk review is an important aspect of the consideration of any proposed capital or investment proposal. The risks will be considered in line with the City Corporation's corporate risk management strategies and commensurate with the City Corporation's low risk appetite. Subject to careful due diligence, the City Corporation may consider a moderately higher level of risk for strategic initiatives, where there is a direct gain to the City Corporation's revenues or where there is Member appetite to deliver high profile projects.
55. The City Corporation maintains a Corporate Risk Register and priority will be given to schemes that mitigate an identified risk.
56. The gateway approval process has three approval tracks: Complex, Regular and Light, with varying levels of member scrutiny. The decision about which track a project should follow depends on the estimated cost and the level of risk. Projects can move between tracks at any stage if it becomes evident that a project is more or less complex than originally anticipated.
57. For each project a costed risk register is prepared to consider the risks associated with the project. This is informed by previous experience of similar projects and other factors, where relevant, such as the age of the asset, its size and its type. The risk register includes mitigations that will be taken to minimise the risk and a financial assessment of the likely cost should the mitigated risks crystallise. In addition, major projects include an element of optimism bias in line with HM Treasury guidance to mitigate the financial implication of delays and/or increased costs.

TREASURY MANAGEMENT

58. The capital strategy is integrated with its treasury management activity as the City Corporation's capital expenditure plans and its approach to financing that expenditure will drive the organisation's need for borrowing.
59. The Treasury Management Strategy Statement outlines how the City Corporation will carry out its treasury management activities. This statement is reviewed annually by the Court of Common Council. Treasury management activity is scrutinised by the Audit and Risk Management Committee.

60. The Treasury Management Strategy Statement outlines the organisation's borrowing strategy, which aims to make sure that sufficient cash is available to deliver the City Corporation's capital programme as planned. Consideration will be given to obtaining new external debt to meet some or all of the City Corporation's borrowing requirement in 2019/20. Any borrowing decision will be undertaken in the context of the managing interest rate exposure in order to contain the organisation's interest costs.
61. The City Corporation faces a number of key risks in terms of servicing its current and future debt requirement including interest rate risk, refinancing risk and liquidity risk. To control these risks, the City Corporation maintains treasury indicators which are set out in the Treasury Management Strategy Statement.

KNOWLEDGE AND SKILLS

62. The City Corporation 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. In addition, the Projects Sub Committee is instigating an accredited programme of training for project managers.
63. The City Corporation establishes project teams from all the professional disciplines from across the City Corporation 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.
64. Within the Court of Common Council there are also a number of Members who have substantial professional expertise which assist when making crucial capital investment decisions. Some specialist committees, such as Property Investment Board, co-opt external members with specific expertise to further inform the decision-making process.

BACKGROUND DOCUMENTS

Strategic Property Annual Update & Strategy for 2019

City Fund Portfolio Update and Strategic Review January 2019

City's Estate Annual Strategy Review December 2018

Treasury Management Strategy Statement & Annual Investment Strategy
2019/20

Corporate Asset Management Strategy

Corporate Project Procedure

City of London Corporate Plan

Corporate Risk Register

Annex A

CORE PRINCIPLES UNDERPINNING THE CAPITAL PROGRAMME

In considering schemes for inclusion in the capital programme, regard will be had to the following principles:

- schemes to be included in the Capital Programme, in accordance with the Project Procedure, follow an appropriate level of due diligence and assurance regarding deliverability/practicable
- prior to mobilisation, all projects complete the gateway process which ensure they are affordable and sustainable. This includes careful consideration of value for money and options appraisal
- capital appraisal should promote schemes which provide a direct gain to the City Corporation's revenues within agreed risk appetite, e.g. commercial investment return, "invest to save" or "income generation" outcomes or attract external investment.
- environmental and social sustainability issues should be built into project appraisal
- the financial implications of capital investment decisions is considered at Gateway 4 and will be properly appraised as part of the determination process
- projects will not proceed unless full funding has been identified and approved as part of the Gateway process.
- available capital funding will be optimised e.g. through surplus asset disposal strategy,
- maximising available capital resources through use of planning gain, corporately pooling capital receipts and by exploring external financing sources
- that capital funding decisions minimise or mitigate the ongoing revenue implications of capital investment decisions
- the financial implications of capital investment decisions should be fully integrated into revenue budget and longer-term financial plans
- robust governance arrangements through the Corporate project procedure and other member oversight are in place for all programmes and projects, clearly defining responsibility for the delivery of individual schemes within the capital programme
- all capital schemes follow appropriate project management arrangements
- there are effective working relationships with partners
- that projects are reviewed on completion to ensure key learning opportunities are maximised