

**DRAFT CAPITAL STRATEGY
Financial Years 2020/21 to 2024/25**

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 included in the capital programme will be subject to a gateway process overseen by Project Sub-Committee. The only exception to this is 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. This oversight includes feasibility and option appraisal costs which are classified as supplementary revenue project expenditures. 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

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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, including the major projects and new schemes approved via the annual bid process 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/income generating (payback within 5 years);
 - major renewals of income generating assets;
 - must address a risk on the Corporate Risk Register or that would otherwise be escalated to the register e.g. replacement of critical end of life assets, schemes required to deliver high priority policies and schemes with high reputational impact;
 - must have a sound business case clearly demonstrating the negative impact of the scheme not going ahead such as material penalty costs or loss of income.

In preparation for the 2020/21 annual budget, an annual capital bid process has been introduced to facilitate the strategic allocation of resources to the highest priority schemes.

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 Project Sub-Committee, which scrutinises individual projects, and the Resource Allocation Sub-Committee, which considers the overall programme of project activity and funding. Decisions about projects are made in conjunction with service committees and the Court of Common Council (for high

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value projects). Major Projects are managed directly through the Capital Buildings Committee or Policy and Resources Committee.

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 all 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 progressing to the capital programme comply with standing orders, financial regulations, project procedure (with the exception of the major projects under the control of the Capital Buildings Committee), procurement code and rules and are subject to confirmation of funding.

SHORT, MEDIUM AND LONG-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 intention 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.

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23. Such a sizeable property portfolio requires significant capital and revenue investment to maintain it and in the case of the investment property to 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 a fundamental review to determine a target operating model, which will incorporate 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 and supplementary revenue project plans, which include costs of feasibility and option appraisal and the indicative cost of schemes still under development, are as follows:

	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m	2023/24 £m	Later Years £m	Total £m
City Fund	107.6	159.3	336.6	323.5	218.4	145.6	1,291.0
City's Cash	51.5	195.5	191.1	209.3	61.9	773.8	1,483.1
	159.1	354.8	527.7	532.8	280.3	919.4	2,774.1

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

	City Fund £m	City's Cash £m	Total £m
Major Projects	886.8	1,258.9	2,145.7
Capital Programme	278.2	195.0	473.2
New Bids	126.0	29.2	155.2
	1,291.0	1,483.1	2,774.1

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, future currently uncertain with the main expenditures 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. The revenue impact of interest payable on external borrowing results in significant revenue pressures, together with the additional statutory City Fund requirement for a Minimum Revenue Provision towards the repayment of principal.

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The final decision on progression of the major projects will be dependent on the identification of a sustainable funding strategy, with funding options to be considered during 2020/21.

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

- Investment Property refurbishments
- Freeman's School Main House refurbishment
- Infrastructure improvements at the Old Bailey
- Social Housing Decent Homes refurbishments and new affordable housing units
- Decant Estate for City of London Police
- Various highways and public realm projects

29. New bids include:

- Cash flow financing for police, HRA and private school
- Critical end of life asset replacements (mainly building infrastructure and IT)
- Statutory compliance/health and safety projects
- Spend to save schemes with payback < 5 years
- Rough Sleeping initiatives
- 'Secure City' Infrastructure
- Public Realm improvements

30. Following the agreement of a new corporate target operating model, revised prioritisation criteria may follow to inform future resource allocation.

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 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.

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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. Asset Management Plans and the core processes necessary to draft and implement effectively across the Operational Estate have been substantially developed through the Asset Management Service Based Review (AM SBR). The revised processes, due to be approved on completion of the AM SBR in April 2020, will ensure the plans are better aligned with the respective Business Plan cycle. The processes also facilitate a detailed 'Asset Challenge' to ensure targeted investment in operational asset that are fit for purpose, allowing also for consideration of underutilised assets for alternative use and/or the potential of a capital receipt/income. Other outcomes from the AM SBR support improvements to financial sustainability, corporate policies and controls, data management, strategic asset management, delivering asset management related projects, compliance and operational property management.

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 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" benchmark. The target set is to outperform the MSCI Return Benchmarks for Total Return on an annualised five-year basis. There is a

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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.
 - Surplus cash balances (internal borrowing)

Any capital expenditure not financed by the above will need to be funded by prudential borrowing which can 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.

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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. 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 external 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. Subject to careful due diligence, the City Corporation will consider the appropriate 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 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. Maintenance of a costed risk register to identify and keep under review the risks associated with projects is Corporation best practice and most projects comply. Costed risks are informed by previous experience of similar projects and other

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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, the costs of 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 ensure the delivery of the City Corporation's capital programme as planned. Any borrowing decision will be undertaken in the context of 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.
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 generally 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 assists 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 January 2020

City Fund Portfolio Update and Strategic Review January 2020

City's Estate Annual Strategy Review December 2019

Treasury Management Strategy Statement 2020/21

Corporate Property 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 (except major projects) complete the gateway process which ensure they are affordable and sustainable. This includes careful consideration of value for money and options appraisal
- mobilisation of the major projects is subject to scrutiny of the Capital Buildings Committee.
- 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 to implementation 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 and strategic investment disposals,
- 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
- a Project Management Academy is being developed to ensure appropriate project management skills are applied
- there are effective working relationships with partners
- that projects are reviewed on completion to ensure key learning opportunities are maximised