Committees: Audit & Risk Management Committee – For Decision Finance Committee – For Information	**Dated:** 23 March 2021 13 April 2021
Subject: Deep Dive Review of CR35 - Unsustainable Medium-Term Finances	**Public**
Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?	7
Does this proposal require extra revenue and/or capital spending?	**N**
If so, how much?	**N/A**
What is the source of Funding?	**N/A**
Has this Funding Source been agreed with the Chamberlain's Department?	**N/A**
Report of: Chamberlain	**For Decision**
Report author: Caroline Al-Beyerty, Deputy Chamberlain	

Summary

This deep dive report updates the CR35 risk on the Corporation's Medium-Term Finances. This is timely as the Court on 4 March agreed the budget plans for 2021/22 and the medium-term financial plan (MTFP) and aligns with the target risk date of end March for reviewing and moving the Risk from Red 24 to Amber 12.

Although significant challenges lie ahead in terms of savings implementation (including from TOM implementation), income loss (from rental, Business Rate and Barbican income) and external threats, the key mitigations are nonetheless in place, which means that Members can now revisit the RAG status of the risk.

The officer review process which precedes a recommendation to the Audit and Risk Management Committee has4 been completed, but is supportive of a move from Red to Amber on the understanding that it could be re-escalated to Red in the event of changes to the external environment and delays in internal mitigations, which will be tracked by the Efficiency & Performance Sub-Committee.

The January Audit and Risk Management Committee undertook a deep dive on the Police funding risk (CR23). Proposed next steps for this risk are firstly to retain it as a separate corporate risk for the next 6 months and then to consider whether to incorporate relevant elements into the Corporation's Medium-Term Financial Plan risk (CR35) and devolve it to the Police Authority risk register.

Recommendations:

Members are asked to:

- endorse the officer recommendation to adjust the RAG status from Red to Amber, in line with the target risk score, following the adoption of key mitigations.

- note the proposal to retain the Police funding risk as a separate corporate risk for the next 6 months and then to consider whether to integrate into the wider finance risk, subject to progress on moving to sustainable budget plans.

Main Report

Background

1. The CR35 Unsustainable Medium-Term Finances risk was endorsed by the Audit & Risk Management Committee in July 2020; the purpose of the risk was to consolidate and clearly capture the risk exposure to the City Corporation's finances both in the short and medium-term. CR35 highlights a number of key areas of risk and mitigating actions have been put in place.

Current Position

2. The CR35 Unsustainable Medium-Term Finances Risk has had a risk score of red 24, prior to meeting the target score of 12 by31 March 2021.

3. **In year position**: Budget adjustments of £29.9m across all funds were agreed by the Court of Common Council in December 2020 - comprising £17.2m to local risk budgets and £12.7m for anticipated investment income losses. Mitigations include spend reduction; furloughing of staff not able to work; and recovery of lost City Fund income from the government's compensation scheme expected to be £11.7m. Against the revised budget, the anticipated year end position is an overspend of £1.8m, mainly in City's Cash.

4. **Across the medium-term horizon**, the greatest risks to financial sustainability are loss of investment income on all funds; volatility in retained business rate income in City Fund from appeals; and delays in flight-path savings. Sums to mitigate risk are being held in Reserves - £30m on City Fund and £20m on BHE (on a holding basis only). The City Corporation is already drawing down on City's Cash Reserves by £526m across the planning horizon to 2024/25, which is sustainable over the medium term, but not if that rate of drawdown is continued in the longer 10-year horizon.

5. **Actions/Mitigations:** there are seven key actions that were assigned to mitigate this risk by the target date.

CR 35a - Tracking and where possible limiting the negative impact on key income streams and bad debt

6. Income streams and debt levels are being monitored on a monthly basis; and the key income streams regarding investment property and business rates are covered in more detail below. The Budget for 21/22 includes reduced income from both rents and business rates, with recovery profiled across the medium term.

CR 35b – Securing flight path savings and understanding service impacts

7. Scrutiny/monitoring of flight path savings was approved by the Efficiency and Performance Sub Committee on 26th February. To provide reassurance to

Members that the flight path savings remain on track, officers are seeking to track information, at departmental and corporate levels, regarding performance against the Fundamental Review programme, the 12% savings target and the Target Operating Model programme, so appropriate mitigating action can be taken where necessary.

CR 35c - To reduce strain on cash flow.

8. The cash flow position is holding up well. The City Corporation remains liquid and the outlook for near term cash flows is robust. Cash flow modelling for major commitments is being carried out and will be reported to Financial Investment Board in May 2021. The next tranche of private placement monies, £200m, for City's Cash will be received in July 2021.

CR 35d – Maximising the recovery from government of increased expenditure related to COVID measures

9. Covid related spend is being coded and monitored, with an estimated claim of up to £10m for loss of fees & charges on City Fund. Total claim made to date is £5.3m (£1.5m received for qtr1 and £3.8m pending). The use of the furlough scheme has resulted in the recovery of £4m to end of January.

CR 35e – Mitigating the impact of Business Rate income shortfall

10. The impact of COVID-19 has been to lower the collection rate for business rates. Collection is now 4.9% below previous year, an improvement from 6% in December. Modelling a more pessimistic view on retained business rates income in 2021/22 removes almost all of the current £27m growth - pushing City Fund into an estimated £19m deficit.

11. Central Government has recognised the cashflow impacts of business rates and has deferred its share for April-June, which has been re-profiled over the reminder of the year. The Government is also allowing authorities to spread the impact of business rate deficits over 3 years.

12. However, the impact of business rate appeals linked to COVID could be far more significant. It is currently unclear what the approach from the Valuation Office will be, nor has the interaction with wider business rate income issues been clarified. But moves for potentially large-scale reductions in rateable value appear to be on hold for now. The Deputy Chamberlain, with the Society of London Treasurers, is liaising with MHCLG on the severity of the potential impact across the whole of local government financing with a view to establishing a funding solution.

CR 35f – Managing the impact on our investment assets

13. The values of the City's Cash and BHE financial investment portfolios have continued to grow steadily following the downturn in financial markets in March 2020. As at 31 December 2020, the City's Cash and BHE financial investment portfolios have an estimated value of £874m and £837m, respectively. Consequently, both portfolios have fully recovered the losses experienced during March's disruptive market conditions, and both portfolios now exceed their pre-Covid (December 2019) valuations by 9%. Future performance over 2021 will likely be determined by virus-related developments; the pace and extent of the global economic recovery; and the ability of the Corporation's appointed specialist fund

managers to meet their individual objectives. The Financial Investment Board (which oversees the Corporation's financial investment activity) manages this uncertainty by diversifying sources of risk and return amongst and within major asset classes and by maintaining vigilant oversight of individual asset managers' capacity to add value and enhance performance.

14. On investment properties: arrears stand at 15.86% against a target of 1% which is equivalent to £28.8m, most of which is rent. Of these £28.8m arrears £7.4m relates to deferred rent due to be repaid, monthly, over the coming year. £25m relate to rent service charges.

15. The main effort is to ensure that the portfolio remains tenanted. Rent concessions (rent frees and rent deferrals) together with turnover rents for retail and food & beverage are aimed at retaining as many tenants as possible. If tenants default, there is a high risk of long periods (void marketing/letting period and rent free incentives totalling up to 24 months) before properties are income producing again. Although some tenants have gone into administration, our voids have not increased significantly. The latest vacancy report, as at 1st December, showed our vacancy rate was 2.52%, which was lower than the City vacancy rate of 5.1% and the West End vacancy rate of 5.9%. There was a slight increase of 15,232 sq ft in vacant space from 1st June to 1st December.

CR 35g – Managing the Impact on the MTFP

16. For 2021/22, the City Corporation is responding to the financial challenge in two ways:
    - a general budget reduction of 12% in 2021/22 for the local authority City Fund and City's Cash; and
    - making organisational efficiencies through a new target operating model which will make an increasing contribution over the medium term.

17. These measures put the City Corporation on track for a sustainable Medium-Term Financial Plan. But with a global pandemic and worsening economic position, pressures and risks for the City Corporation's finances will continue into the 2021/22 fiscal year. The task to secure the future savings 'flight path' remains and there is a need to manage the significant remaining COVID risks and unprecedented range of external challenges e.g. Local Government and Police Spending Reviews and Business Rates income fluctuations. Lower levels of investment income, with a recovery period and a business rate reset in 2022/23 have been modelled to stress test the impact on the MTFP. Further work will be needed to identify savings that meet the full extent of the financial gap over the medium-term and provide a build back better/new priorities fund for new policy initiatives, principally the Climate Action Strategy. For this reason, £30m is being held within City Fund reserves to mitigate the above risks.

18. Bridge House Estates has also been hard hit by COVID income losses and £20m of the £200m unrestricted funds previously allocated for charitable funding will be retained until such time as the charity is able to confirm the original allocation can be supported.

CR 35h - Reassessing the Fundamental Review project plan

19. Action migrated into CR 35i below.

CR 35i Implementing Target Operating Model and FR Savings

20. Fundamental Review proposals affecting staff were put into abeyance during the City Corporation's response to Covid-19. The Flexible Retirement Scheme for those aged 60+ is currently being implemented. Other savings relating to organisation design and an associated reduction in headcount are expected to begin from the new financial year, with full year impact in 2022/23. Performance monitoring will be undertaken by the Efficiency and Performance Sub Committee to ensure delivery of flight path savings and impact on service delivery.

Conclusion

The measures and mitigations outlined in this report put the City Corporation on track for a sustainable Medium-Term Financial Plan. But with a global pandemic and uncertain economic position, pressures and risks for the City Corporation's finances will continue into the 2021/22 fiscal year and beyond. It is therefore recommended that the risk be moved from Red to Amber by the end March target date, on the understanding that it could be re-escalated again in the event of a material change in the external environment or delays in internal mitigations.

Appendices

- Appendix 1 – CR35 Risk

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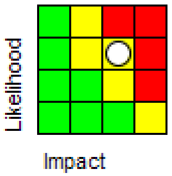
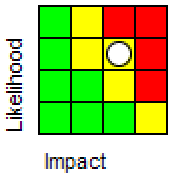
CHB Corporate and departmental risks - detailed report EXCLUDING COMPLETED ACTIONS

Report Author: Leah Woodlock
Generated on: 11 March 2021

Rows are sorted by Risk Score

Risk no, title, creation date, owner	Risk Description (Cause, Event, Impact)	Current Risk Rating & Score		Risk Update and date of update	Target Risk Rating & Score		Target Date	Current Risk score change indicator
CR35 Unsustainable Medium Term Finances	**Causes:** Anticipated decline in public sector funding (local government and Police), increasing demands (revenue and capital) and an ambitious programme of major project delivery threaten our ability to continue to deliver a vibrant and thriving Square Mile Normal course of business unable to function due to COVID 19 restrictions BREXIT compounding market uncertainty and exacerbating the economic downturn. Major contraction in key income streams and increase in bad debts. In particular, that lower occupancy levels in city properties reduce investment property income over the medium term. Police Transform programme fails to realise the budget mitigations anticipated. Reduction in the value of investments- property and securities- reduces available capital for major project financing.		**24**	Budget adjustments of £29.9m across all funds agreed by Court on December 2020- comprising £17.2m to local risk budgets and £12.7m for anticipated investment income losses. Mitigations include spend reduction; furloughing of casual staff and permanent staff not able to work; and recovery of lost City Fund income from the government's compensation scheme expected to be £11.7m. Post changes- anticipated year end overspend of £1.8m, mainly in City's Cash. Cash flow position is holding up well. Balance Sheet- valuers are currently estimating property valuations for year end.		**12**	31-Mar-2021	Reducing

19-Jun-2020 Caroline Al-Beyerty	**Event:** Inability to contain financial pressures within year (2020/21) and compensatory savings and/or income generation to meet the Corporation's forecast medium term financial deficit will not be realised. **Effects:** Additional savings over and above those identified through the Fundamental Review to meet this challenge are required and/or closure in some areas reserves are utilised and/or services stopped. The City Corporation's reputation is damaged due to failure to meet financial objectives or the need to reduce services / service levels to business and community. Being unable to set a balanced budget which is a statutory requirement for City Fund. Spend is not aligned to Corporate Plan outcomes resulting in suboptimal use of resources and/or poor performance. Capital projects stalled due to COVID restrictions. Stakeholders experiencing reduced services and service closures.			Securities portfolio- after an initial drop has largely recovered the Dec 2019 valuation. Medium term horizon- greatest risks are loss of investment income on all funds; and volatility in retained business rate income in City Fund from appeals. Sums to mitigate risk are being held in Reserves- £30m on City Fund and £20m on BHE. Already drawing down on City's Cash Reserves by £526m across the planning horizon to 2024/25 (which is sustainable given modelling of balance sheet recovery). Performance monitoring undertaken by Efficiency and Performance Sub Committee to ensure delivery of flight path savings and impact on service delivery. Target risk met. **5 March 2021**				Constant

Action no	Action description	Latest Note	Action owner	Latest Note Date	Due Date
CR 35a	A reduction in key income streams and increase in bad debt	This is being monitored monthly, with action being taken to reduce spend where possible. Budget forecast for 21/22 includes reduced income, with recovery profiled across the medium term.	Sonia Virdee	11 Mar 2021	31-Mar-2021
CR 35b	To reduce strain on cash flow.	• The Corporation remains very liquid and the outlook for near term cash flows is robust. • Cash flowing modelling for major commitments is being carried out. Next tranche, £200m, of private placement monies for City's Cash will be in July 2021.	James Graham; Sonia Virdee	11 Mar 2021	31-Mar-2021

CR 35c	Increased expenditure related to COVID measures- maximise recovery from government	• Maximising recovery from government- spend is being coded and monitored. Estimated claim of up to £11.7m for loss of fees & charges on City Fund. Total claim made to date is £5.3m (£1.5m received for qtr1 and £3.8m pending). • Furloughing workers where appropriate has been done recovering £4m to end of January	Sonia Virdee	11 Mar 2021	31-Mar-2021
CR 35d	Inability of occupiers to pay rates as their income falls an business models are damaged. A reduction in demand for office space in the square mile, leading to lower occupation and business rate income. The Corporation is currently benefitting from growth in business rates retained income of c£40m. Non-payment of rates across London leading to difficulties in meeting cash flow payments as host of the pool.	• Monthly monitoring in place. The impact of COVID-19 has been to lower the collection rate for business rates. Collection now 4.9% below previous year, an improvement from 6% in December. • The Govt has recognised the cashflow impacts of business rates and has deferred its share for April-June, which has been re-profiled over the reminder of the year. The Govt is also allowing authorities to spread the impact of business rate deficits over 3 years. • The impact of business rate appeal linked to COVID could be significant. Not clear what the approach will be from the VoA. Liaising with MHCLG on potential solutions. Impacts will continue to be monitored.	Phil Black	11 Mar 2021	31-Mar-2021
CR 35e	Impact on investments: securities/property	• The values of the three main financial investment portfolios have continued to grow steadily • COL's Pension Fund contributions are fixed until 2023, providing some protection, whilst the diversified asset allocation strategies and use of active management across all three funds should continue to deliver some stability if general market moves become extreme again. • Our voids have not increased significantly, the latest vacancy report, as at 1st December, showed our vacancy rate was 2.52%, which was lower than the City vacancy rate of 5.1% and the West End vacancy rate of 5.9%. There was a slight increase of 15,232 sq ft in vacant space from 1st June to 1st December.	Nicholas Gill; James Graham	11 Mar 2021	31-Mar-2021
CR 35f	Impact on the MTFP	• Lower investment income modelled into MTFP and business rate reset in 22/23. • Sums to mitigate risk are being held in Reserves- £30m on City Fund and £20m on BHE. Already drawing down on City's Cash Reserves by £526m across the planning horizon to 2024/25 (which is sustainable given modelling of balance sheet recovery) FR proposals affecting staff put into abeyance during CoLC's response to Covid-19. • FR proposals affected by COVID have been reprofiled.	Caroline Al-Beyerty	11 Mar 2021	31-Mar-2021
CR 35h	To implement the Fundamental Review project plan- TOM	• FR proposals affecting staff put into abeyance during CoLC's response to Covid-19. • The Flexible Retirement Scheme for those aged 60+ is currently being implemented. • Other savings relating to organisation design and an associated reduction in headcount are expected to begin from the new financial year, with full year impact in 2022/23.	Chrissie Morgan	11 Mar 2021	31-Mar-2021