Colchester

Trading Board

Item 9

18 June 2014

Report of	**Head of Commercial Services**	**Author**	**Fiona Duhamel** ☏ **282976**
Title	**Proposal to establish a Revolving Investment Fund**		
Wards affected	All		

This report concerns the proposal to establish a Revolving Investment Fund (RIF) to drive forward the development of high income producing assets in order to meet the Council's future financial targets

1. Decisions Required

1.1 To recommend to Cabinet that it considers:

(a) establishing a Revolving Investment Fund (RIF) for the commercial management, disposal of and investment into key assets in order to drive forward income generation projects.

(b) ringfencing capital receipts from a number of key identified assets and limited revenue funding, subject to agreement of final details including Terms of Reference for the Revolving Investment Fund.

(c) creating a Cabinet committee to be known as the RIF Committee in accordance with the proposals contained at paragraph 10.5 of this report.

1.2 To note that subject to the above the final details relating to the creation and management of the Revolving Investment Fund including Terms of Reference will be the subject of a report to the next Cabinet meeting.

2. Reasons for Decisions

2.1 There is a need to carry out investment decisions in a more commercially focused way to secure high levels of future income for the Council.

2.2 A ringfenced account will provide a structured process to deliver high income producing developments and investments, which can minimise financing costs and has the ability to move swiftly to secure the best commercial outcomes.

3. Alternative Options

3.1 The Council could continue to allocate capital receipts for specific income producing opportunities on a case by case basis. However there are a number of benefits from taking a more streamlined strategic approach to investment decisions including, more flexibility to act quickly when opportunities arise, the ability to forward fund potential schemes using receipts already in the Fund and the ability to take a longer term approach to investment management of key assets.

3.2 The Council could seek to set up an independent asset vehicle specifically for the development of its key assets. A good deal of research has been carried out looking at various models relating to asset based vehicles and whilst there is a clear need for a special purpose vehicle ("SPV") in some circumstances eg for commercial trading activities and for housing focused development, at this stage it is not clear what benefits would be derived from setting up a stand alone company.

4. Supporting Information

4.1 The Council received independent legal advice from Pinsent Masons in April 2013 relating to asset development vehicles, which was considered at a Leadership Team meeting. At a subsequent Leadership Team meeting, following the presentation of an interim report on SPV options, it was noted that a final report would be produced by officers which focused solely on the initial structure and implications of an internal ringfenced account for development assets.

4.2 This action was taken based upon research findings within the interim report which found that:

- There are only a small number of circumstances which require a local authority to set up a formal SPV which relate to "commercial initiatives", particularly trading opportunities.

- If the Council wishes to jointly develop parcels of land with a private sector partner then an SPV will be required.

- Very little evidence exists of Local Authorities setting up formal SPV's for the commercial development of their assets and this is largely because it is difficult to determine substantial up front benefits from the setting up of any company versus known set up and ongoing management costs such as Corporation tax.

4.3 Other councils have however been exploring and introducing internal financial mechanisms which provide for a ring fence of capital receipts with the sole purpose of recycling such funds towards key infrastructure development which cannot be met by the private sector and/or in particular towards investment in income producing assets

Examples

Fife Council recognised that significant infrastructure investment was required to unlock its development/regeneration aspirations in the area. Faced with an economic climate which prevented such infrastructure being delivered by the private sector, the Council developed a revolving infrastructure fund which brought together a range of funding mechanisms, including capital receipts from Council assets and public borrowing and the resultant model was taken forward to the Scottish Government as an exemplar approach.

Chester and West Cheshire County Council also set up a ringfenced structure to deliver its ambitious town centre regeneration objectives. This internal vehicle was used to facilitate the forward funding and purchase of a number of town centre sites which were key to overall delivery of the Masterplan of the area.

4.4 **The Proposed Ringfenced Account and Revolving Investment Model**

4.4.1 With a year on year reduction in government grant to local authorities, it is increasingly important that Council owned assets are managed robustly and commercially to ensure they are creating maximum value.

4.4.2 Councils will have different ways that assets are managed and in particular how capital receipts are allocated. With the increased drive to provide higher levels of revenue income it is vital that a more strategic approach is adopted and that each asset is examined carefully to ensure that its maximum potential is recognised. However, it must also be recognised that not all assets are suitable to lease out and it may be more appropriate to sell in order to gain a capital receipt.

4.4.3 The ringfenced account provides a mechanism that enables councils to take a proactive approach to investment in the delivery of infrastructure or high yielding development through the recycling of capital receipts gained from the sale of a pool of "surplus" assets and from other funding mechanisms. In this way funds are reused (or revolved) as a continuous investment so as to enable a real focus to be given to an objective to derive high levels of income from assets.

4.4.4 The actual financial model developed depends upon available resources and appetite for risk but importantly is can be adapted as needs change or alternative funding mechanisms are developed. For example an initial ringfenced account may just include income from capital receipts but as the model develops and confidence grows, other funding sources can be added such as New Homes Bonus, retained business rates and prudential borrowing.

4.4.5 The Revolving Investment Model is designed to be a long term solution (10-20) years for the delivery of major development schemes and does require capital to be set aside for re investment into future land for development. However, it also provides sufficient flexibility to create short term income opportunities eg PV panels investment.

5. Proposals

5.1 The Proposed Colchester Revolving Investment Fund Model

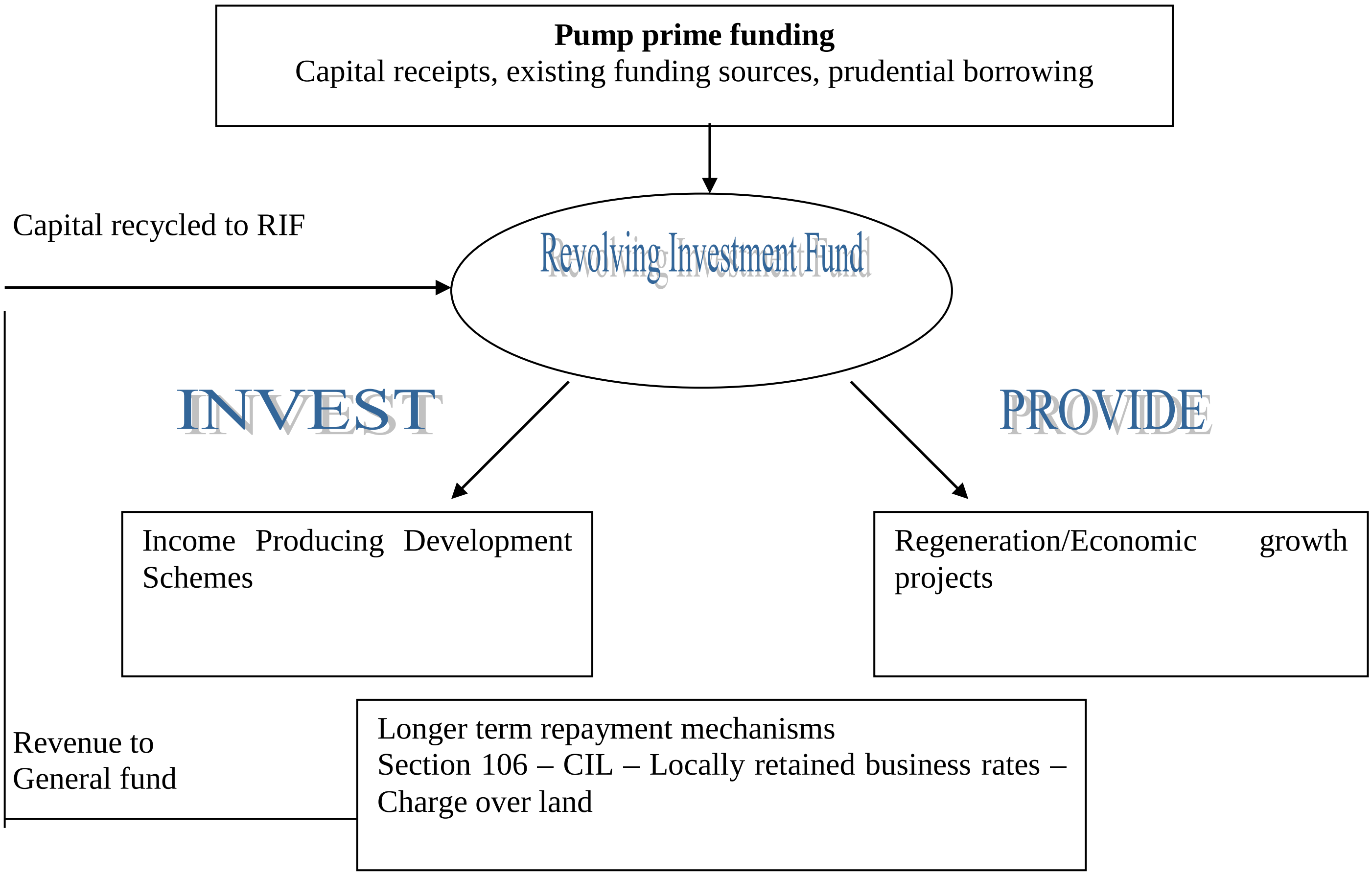
5.1.1 It is proposed that a Revolving Investment Fund Model for Colchester would focus initially on using a ring fenced account to deliver high value income streams through initial capital reinvestment.

5.1.2 As part of the research process an initial list of "developable" assets across the Borough is being drawn up. Such assets need to be considered carefully to understand whether they might provide options for creating high value income or whether market demand might dictate they are sold for a capital receipt on long leases (in only very exceptional cases is it proposed that assets are sold freehold as in the very long term the leasehold structure will provide for another injection of capital or revenue).

5.1.3 Once it has been established which assets can be used to provide a long term revenue stream but require capital for enabling development and which assets can be "sold" for a capital receipt, then further work can take place to establish a 5 year programme of investment.

5.1.4 This programme of investment will show capital receipts anticipated from "sales" over a 5 year period and reinvestment of this capital created would be subject to strict criteria demonstrated within a business case. This is a very simplistic version of the revolving investment fund but as stated previously there is the opportunity to add to the capital ringfenced through other funding mechanisms and there is also the opportunity to spend capital resources on non income producing schemes such as infrastructure and social and economic regeneration.

5,2 An outline of the potential mechanism is shown in Fig 1 below



6. Strategic Plan References

6.1 The proposal contributes to the Council's aim to be more financially sustainable and also delivers against the following areas in the Strategic Plan

6.2 The Regenerating our borough through buildings, employment, leisure and infrastructure

6.3 Bringing investment to the borough

7. Consultation

7.1 This is an internal ringfence which is still subject to formal consultation and scrutiny as with existing capital programme.

8. Publicity Considerations

8.1 None identified

9. Financial implications

9.1 **Financial Implications of Revolving Investment Fund**
There are number of important financial issues to consider as part of operating a ringfenced account including the wider implication on the capital programme.

(i) Impact on the Capital Programme

The current capital programme is funded in 4 main ways:-

- Borrowing
- Revenue contributions
- External contributions (grants, S106, EU money etc)
- Capital receipts (sale of assets)

9.2 The **whole programme** is therefore funded in part by the sale of assets. The creation of a ring fenced account will include some of the largest anticipated capital receipts and therefore potential funding for capital projects outside of the ring fence will be more limited although the overall pot of capital receipts is likely to considerably increase because of the predicted sales within North Colchester and a more pro-active approach to asset management. This however remains a key implication for the Council to consider**.**

9.3 Over recent years it is worth noting that a large proportion of capital receipts have been used to fund regeneration projects. In addition they are used for

- Some major repair projects
- ICT / FSR investment schemes (e.g. the UCC FSR capital investment)
- Some rolling programmes

9.4 If fewer capital receipts are available to support the non-ringfenced capital programme then this places a greater reliance on other funding opportunities such as:-

- One-off New Homes Bonus allocations
- Section 106 contributions
- The building maintenance provision
- Non ringfenced capital receipts (in particular other assets, including operational assets need to be managed more proactively)
- Borrowing

9.5 It is important to note that the ringfenced account remains part of the overall Council capital programme and treasury management activities. Ultimately the Council is not formally bound by the ring fence itself as it is an internal mechanism, but investment decisions taken will begin to restrict options while delivering the desired improved income flows.

(ii) Management of borrowing costs

The revolving investment fund does provide the Council with an opportunity to manage capital investment and the sale of certain capital assets in a strategic way. Decisions on spend and income can be considered as part of a clear programme. In this way it may be possible to consider short term borrowing needs and in doing so minimise the need to set aside money to repay debt (MRP). In simple terms it will possible to consider the use of temporary borrowing in a planned way based on anticipated investment and capital receipt plans.

(iii) Delivering commercial income targets

The UCC FSR includes stretching income targets for additional sustainable revenue streams from assets. Currently, these targets for the next 3 years are in the region of £200k - £400k. It is recognised that to deliver these requires investment and a structured approach to the management of assets which the revolving investment fund based on a ringfenced account provides.

(iv) Delivery of capital investment / receipts – pump priming

Delivering capital investment and generating capital receipts includes, or requires costs. These include:-

- pre development
- master planning
- marketing
- Communications / public engagement
- Technical studies etc

9.6 These costs, which may be treated as revenue or capital as appropriate, can as part of the ring fence be properly planned and budgeted alongside the forecast outcomes.

9.7 The issue of providing some revenue funding **into** the ring fence will be essential to provide some flexibility. The Council has already agreed revenue contributions towards areas likely to be dealt with in the ring fence. These now total £700k and the intention will be to consider transferring these funds into the RIF:-

	2013/14 £'000	*2014/15 £'000*	*Total £'000*
One off contribution to assist with one-off transitional costs associated with commercial land or property deals and towards possible opportunity purchases.	200		200
Contribution to "infrastructure" that we have made from our New Homes Bonus money.	250	250	500
Total	*450*	*250*	*700*

9.8 In addition, there are a number of existing capital projects where remaining balances (subject to any outstanding commitments) could be brought into the ringfenced account. These would include:-

- St Botolphs Regeneration
- North Colchester Development land
- Site disposal costs
- Park and Ride
- A12 junction etc

(v) A practical example - PV panels

The Cabinet agreed to proceed with the investment of £800k in Photo Voltaic panels on 10 Council owned non housing assets in January 2014 following a feasibility period. It was also agreed at Cabinet that the Council would prudentially borrow to cover the cost of this investment.

The projected income from this investment net of borrowing costs is £17k pa assuming a loan over a 20 year period. However a direct capital investment through the proposed revolving investment fund would avoid the borrowing costs such as MRP and interest costs and would produce an average annual income (a mix of savings, incentives and sales) of close to £150k pa with a starting income at Year 1 of £90k.

The return on capital invested is therefore significant at 18.75%.

10. Management and Governance

10.1 Under current financial regulations there are a number of key approval mechanisms:-

- The requirement for Full Council approval of new capital schemes
- Cabinet approval for the release of money to individual capital schemes / transfer of money between projects
- Approval for the sale of land (Portfolio Holder over £150k, Cabinet over £500k)
- All capital receipts are treated as a corporate resource unless specific approval is given by Cabinet.

10.2 The creation of a ringfenced account and a revolving investment fund can therefore be seen as an example of this last point.

10.3 In terms of governance there may be different approaches that could be considered or the Fund could be managed under existing arrangements with Cabinet / Portfolio Holder approval for individual project investment / sales etc

10.4 However in order for the RIF to be managed effectively on a more commercial basis it may be appropriate to consider alternative management arrangements which in turn could create the new governance structure which is outlined below:

10.5 The principle of a ringfenced account set up as a stand alone capital fund which sits alongside the existing capital programme has already been established. It is suggested that governance of the new RIF could be carried out by the creation of a committee of Cabinet to be known as the RIF Committee which would have powers delegated to it by Cabinet. The existing Northern Gateway Shadow Board already exists as an informal committee and could be formally established by Cabinet to become a decision making body. It is suggested that the RIF Committee could comprise the following: the Leader of the Council, and the Portfolio Holders who have responsibility for regeneration, resources and communities. As the RIF Committee would be a committee of Cabinet and will be exercising delegated executive functions, decisions made will be subject to scrutiny and call-in.

10.6 As part of the governance arrangements it is proposed that Cabinet consider giving the RIF Committee delegated powers to make disposal and investment decisions up to a value of £5m, provided that a full business case is submitted to the RIF Committee and certain investment criteria are met. It is suggested that terms of reference for the RIF Committee should be developed for approval at a future Cabinet meeting. It is also suggested that the RIF Committee should be accountable for the operation and management of the RIF and be responsible for developing and administering a number of key activities such as:

- Setting the investment strategy - Developing an approval process for new projects/assets into the fund
- A Project selection process
- Project Appraisal – including analysis of the business case against set criteria
- Developing and monitoring a capital receipts programme
- Establishing a pipeline of new capital funding opportunities and/or new funding sources
- Develop a strategy for any borrowing activities within the fund (subject to the Council's overall treasury management strategy)

10.7 It is suggested that investment decisions (spend of the capital within the RIF) will be based upon a set of agreed criteria. These criteria will include:

- Return on investment (or regeneration outputs for non income producing regeneration projects) – would income from the proposed project meet rates of return required to invest the capital requested?
- Deliverability – including a review of the planning status, barriers to development, market conditions, ownership and legal limitations
- Timescale for commencement of income
- Risk versus reward – Does the projected income outweigh the deliverability risks from the investment of capital, what is the security of income?

10.8 Once established, it is suggested that the RIF Committee should report progress quarterly to Cabinet. Furthermore, the Trading Board should also review performance of the RIF against set targets and including financial and non financial outputs. As the RIF will form part of the capital programme any expenditure should be reported to the Scrutiny Panel on a quarterly basis.

11. Equality, Diversity and Human Rights, Community Safety and Health and Safety implications

11.1 None indentified at this stage.

12. Risk Management Implications

12.1 There is limited risk associated with setting up the RIF as it is still a ringfenced account within the Council and therefore subject to all formal decision making processes. As risks identified through the spending of capital on new projects will be picked up through the criteria for a business case.