The Chartered Institute of
Public Finance & Accountancy

CIPFA

# Warrington Borough Council

## Review of debt/investment risk profile

## July 2023

A Report by:

The Chartered Institute of Public Finance and Accountancy

July 2023

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This review was undertaken in March 2023, and all of the information gathered, and the data analysed by CIPFA was correct at the time of writing this report. The data provided in this report has been reproduced with the permission of the council and is derived from various council reports.

# Contents

1 Executive summary ....................4
2 Introduction ....................6
2.1 Background ....................6
2.2 Requirement ....................6
2.3 Methodology ....................7
3 Current debt and investment position ....................9
3.1 Analysis summary ....................9
3.2 Risks and challenges .................... 13
3.3 Conclusions ....................24
4 Investment/debt management resources ....................26
4.1 Internal teams ....................26
4.2 Access to non-council expertise ....................28
4.3 Decision-making, oversight and governance ....................29
4.4 Conclusions .................... 30
5 Recommendations .................... 31

# 1 Executive summary

This report for the Department for Levelling Up, Housing and Communities (DLUHC), examines Warrington Borough Council's (WBC) indebtedness. We have looked at the overall position, the associated challenges, and the council's capacity to manage them. The background, DLUHC's requirement and our approach are set out in section 1.

WBC's portfolio of debt-funded investments is very large and uniquely complex. It has already been subject to several reviews. At least one of these seems to have admitted defeat, claiming that its team lacked the necessary specialist skills, while the others have been partial or even recommended further review work.

Our analysis of the debt/investment position in section 2 and the associated decision-making and governance in section 3, has been thorough and impartial. And we have drawn some clear inferences, about strengths and potential issues. Nevertheless, a review of this timescale, even given the extra capacity we have added, cannot be expected to get to the bottom of all the issues in play in such a complex and challenging portfolio and we recommend that further (more detailed) work is required to investigate the issues in more detail. Further, our inferences from a limited period of fieldwork and the perspectives of those who have taken on the debt and manage the investments full-time, WBC's senior administrative and financial leadership, might not wholly accord.

Nevertheless, we have found significant common ground. Warrington's debt and investments position is complex and wide ranging making it especially conspicuous creating a particular onus of explanation and justification. Lead officers have indicated that in moving forward, they could certainly make use of expertise to assist with presentational issues associated with the investments. They recognise that the portfolio's classification could be sharper. They already commission specialists to assist with individual investment challenges. They acknowledge that other experts could assist them with the effective management of the portfolio as a whole, providing insight into its risks and opportunities.

Accordingly, we are making a bold and innovative recommendation. We believe that the strategy, classification and management of this scale of portfolio would indeed benefit from third-party input. We recommend the convening of an expert panel, independent of both WBC and DLUHC, to advise on and give specialist support to the portfolio's forward development. The proposal is outlined in section 4. Having aired the idea with a number of interviewees, and found it universally welcomed, we have also informed leading WBC officers of the proposal in our concluding feedback session. We are delighted to say that they embraced it.

From the interviews we conducted with a wide range of officers, elected members and other key council stakeholders we are concerned with the scale of commercial activity and associated debt at Warrington. The senior officers we spoke to presented a convincing narrative of having control of the commercial programme and provided arguments as to why the council has the right level of skills and capabilities to deliver its commercial agenda.

The council's commercial interests have developed over a number of years and reflect a diverse and complex picture of activity across a range of markets and sectors including housing, banking, energy etc. Taken individually, these commercial initiatives are complex in nature and require the organisation to manage and monitor each individual component carefully, reflecting the specialist nature of the portfolio's elements (eg, the bank).

The largest element of the debt relates to loans to housing associations which we anticipate reducing over the coming years where housing associations can get better borrowing rates from other third party lenders. This is likely to reduce the income generated by the council

on these loans in the future with the potential to create a gap in overall revenue and we recommend that the council undertake scenario planning to examine the effect of potential future changes and movements and where they may affect the council's overall financial health.

Prior to the changes to PWLB borrowing for yield, some of the council's investments were drawn down on this basis which was permissible at the time. We have tried to make this as clear as possible in the report, however we couldn't always exactly classify whether a particular loan was provided for yield or regeneration purposes and we therefore recommend that each loan be subject to further scrutiny and review to ensure that the purpose of the loan (and at the same time referencing the original business case) was within the appropriate parameters under the prevailing borrowing regulations.

We have looked at the levels of income from commercial and service investments (see Section 2) and whilst we accept that the council has and will continue to use reserves to mitigate one-off measures, we believe that the council needs to undertake a more sustained review of its commercial portfolio on (a) its future reserves forecast and (b) the MTFP as a whole such that it can effectively plan for unforeseen events.

# 2 Introduction

## 2.1 Background

Since May 2022, DLUHC has been working with and monitoring several local councils with high levels of indebtedness relative to their revenue budgets, reserves or Council Tax base. Warrington Borough Council (WBC) is one such council.

Working with partners, CIPFA is leading a programme of DLUHC-commissioned reviews to examine the financial management and sustainability of selected councils. As part of this programme, in early 2023, the Department asked CIPFA to review the debt conditions and management arrangements in WBC.

## 2.2 Requirement

Following an initial 2-day 'triage' assessment of each of the affected councils, conducted in January/February, CIPFA and the Department concluded that each council required a substantial review. A further 29-day investigation was allocated to each council. Work was to be undertaken in February and March 2023, and draft investigations and findings presented to the Department, subject to any unavoidable constraints, by the end of the week beginning 20 March 2023.

Emailing the authorities to advise them of project commencement, DLUHC summarised the review work as follows:

***Objectives***

First, to assess the level of risk that the council is exposed to due to its current debt and investment profile and future capital plans. In assessing this, the review should consider both the inherent risk and the council's arrangements to manage risk. The review must consider the forward position of the council and the level of risk to financial stability due to sensitivity to changes in future assumptions.

Secondly, to include as part of the considerations of the review whether it is appropriate and necessary for the councils to take actions to reduce its risk (for example, by reducing debt), and the options by which the council may do this and the viability of such options. The report should provide recommendations that can reasonably inform the governments and council's consideration of further actions.

The focus of the review is intended to be on the financial risks arising due to the council's investment and debt profile; we expect the review to consider other elements of the council's finances so far as they are relevant.

***Review areas***

The review will cover, but is not limited to, the following main areas in pursuit of the above objectives:

An assessment of the council's financial risk due to its profile of investments and debt (current and planned). Investments includes both financial and non-financial investments (property) that generate commercial income. This is not limited to investments purely or primarily for profit. The review is expected to take a risk-based approach and identify and focus on those investments which present the highest potential financial risk (by value, complexity or sensitivity).

An assessment of the council's capacity, capability and arrangements for managing its investment and debt risks, and whether these are sufficient and appropriate for the council's activity. Review Area 1 sets out a review of the council's inherent risk exposure, the intent of Review Area 2 is to assess the council's arrangements to manage and mitigate its risk position.

An assessment of actions the council can reasonably take to reduce its debt and commercial exposure, or other actions it can take, with respect to reducing its overall level of risk over the short, medium and long-term. The government has set out that any actions to reduce capital risk should seek to avoid unintended consequences or risks to value for money. The review should consider options and consider their viability.

During the course of their work, the reviewers may request information, data and interviews they deem appropriate to meet the objectives and cover the review areas. The Department for Levelling Up, Housing and Communities appreciates the cooperation of the council with this review.

## 2.3 Methodology

To address DLUHC's 3 questions, the broad approach was as follows:

*Desktop analysis*

DLUHC provided an extensive document library. This in turn had largely been supplied to them by the affected authorities. In WBC's case the volume of documentation was especially extensive. We reviewed this material and made supplementary document requests to the council and also examined other relevant materials for purposes of comparison. WBC officers complied with our requests, again in volume. We would like to record our gratitude to them for their assistance.

*Specialised inputs*

Some comparative data analyses were conducted on issues such as commercial property, revenue spend, and indebtedness. Where relevant they have been used in the body of the report. The Good Governance Institute conducted a separate light-touch assessment of governance and decision-making in each affected authority.

*Interviews*

The bulk of the fieldwork comprised interviews. These provided the invaluable 'triangulation' of our analysis. Council officers, members, auditors and other experts were invited to give views and respond to queries provoked by documentary evidence. We would like to thank everyone involved for their courtesy and constructiveness.

*Report drafting, feedback and fact-checking*

The above inputs were then analysed and subjected to our professional and expert judgement. The result is this report.

The reports belong to DLUHC and are thus submitted 'sight unseen' from the viewpoint of the affected councils. Nevertheless, we have kept WBC abreast of our work. Specifically, we have shared our conclusion, set out in Section 4 of this report, to minimise 'surprises'.

We have also endeavoured to fact-check figures and their implications with the affected authorities. It is worth sharing, however, several limitations on this checking.

A conventional finance review might examine revenue allocations and outturns for a service with some certainty. Councils might even be able to provide information on capital spending with some assurance, notwithstanding the unpredictability of the construction market, especially where contracts have placed constraints on expenditure. However, debt-funded investments are affected by many variables, some changing in real time. This limits the accuracy of any statements concerning them almost from the moment they are set down.

As far as possible we have used WBC data, citing sources and timings. We have informed the council of our approach but have made them aware that the inevitable changeability of figures has presented inherent challenges in marshalling evidence, defining baseline positions, ensuring that interrelations between issues are tracked, and achieving consistency. Indeed, we consider that this is almost certainly a day-to-day challenge. Managing large portfolios, comprising perhaps commercial property, regeneration interventions, housing programmes, support for council companies, and even loans to or shares in local enterprise, is a skilled, time-consuming and exacting business.

# 3 Current debt and investment position

## 3.1 Analysis summary

***Context***

Warrington Borough Council has significantly grown and diversified its investment portfolio since 2016/17. These investments, acquisitions and loan transactions were entered into either for yield or regeneration purposes. Justified by their then consistency with the commercial and entrepreneurial thrust of Government policy, the investments have generated income, which has contributed to council revenue budgets. They have also been a major part of WBC's programme to support the local economy and promote social wellbeing. However, since 2016, the economic environment has changed including a number of major commercial and financial failures in local government. Indeed, recent examples including the significant financial issues and commercial risks now faced by the likes of Woking are bringing local authority commercial programmes into a much sharper focus.

WBC holds financial assets and long-term debts outside of service operations totalling in the region of £1,249 million. The portfolio includes:

- **loans** to companies and Registered Social Landlords
- **shareholdings and company interests** (counterparty investments) in a challenger bank, energy and renewables companies, and housing development and management companies
- **property acquisitions and holdings** in and out of area such as Birchwood Park, supermarkets etc.
- **regeneration assets** including Town Centre redevelopment

The growth in the council's investment portfolio has largely been financed through debt. WBC's debt burden is one of the highest among English unitary authorities and the highest in its peer group. There are plainly risks associated with this indebtedness, particularly the viability of repayment over the long-term, affected in turn by the council's original position on Minimum Revenue Provision (MRP) policy. In their June 2022 Audit Findings Report, based on recent work on WBC's 2017/18 accounts, Grant Thornton, the council's external auditor, state that, "The council has adopted a bold approach to either help the regeneration of the local economy and/or support the council's financial stability. This approach has led to investments in Redwood Bank and Birchwood Park. This approach brings increased risks which needs to be carefully managed and monitored."

The council had been making investments for some time, particularly in its loans to housing associations. The debt position rose more sharply from 2016/17 however, in line with the acquisitions mentioned above.

Table 1 shows that as at 31 December 2022, WBC's borrowing stood at £1,777 million. The majority, £1,465 million, is from the Public Works Loan Board (PWLB). This borrowing is offset by cash investments of £211 million, leaving net borrowing of £1,565 million. The council calculates that £308 million of this borrowing relates to running council services, for example highways schemes, with the remaining £1,259 million being for commercial and socio-economic activities.

*Table 1: The council's treasury and non-treasury portfolio position as at 31 December 2022 (Treasury Management Strategy 2023/24)*

| Current Portfolio Position | Principal £m | Total £m | Average Interest Rate % |
|---|---|---|---|
| **Fixed Rate Funding** | | | |
| - Public Works Loans Board | 1,465.480 | | 2.295 |
| - Money Market | 114.119 | | 2.368 |
| - Temporary Borrowing | 47.140 | 1,626.740 | 1.305 |
| **Variable Rate Funding** | | | |
| - Public Works Loans Board | | | |
| - Money Market | 150.000 | 150.000 | 0.909 |
| **TOTAL BORROWING** | | **1,776.740** | 2.260 |
| **Council Investments** | | | |
| - Externally Managed | (126.138) | | 5.321 |
| - Internally Managed | (0.549) | | 3.589 |
| - Call Accounts | (84.677) | (211.364) | 1.662 |
| **TOTAL INVESTMENTS** | | **(211.364)** | **3.982** |
| **NET BORROWING** | | **1,565.376** | |
| **Non-Treasury Investments** | | | |
| - Group Entities | (306.021) | | |
| - Loans to Housing Assoc. & Commercial | (542.075) | | |
| - Investment Properties | (410.854) | **(1,258.951)** | |
| **Indicative Net Borrowing (after deduction of non-treasury investments)** | | **306.425** | |

Table 2 shows WBC capital spend plans for 2023 to 2026 for 'invest to save' schemes. The majority of this comprises loan arrangements for housing associations. These loans, should they be fully drawn down, would take total loans to housing associations to £920.7 million.

*Table 2: Invest to save capital programme*

| Project Name | 2023/24 (£m) | 2024/25 (£m) | 2025/26 (£m) | TOTAL (£m) |
|---|---|---|---|---|
| **Corporate Services** | | | | |
| Loans to Housing Associations | 125.000 | 125.000 | 126.072 | 376.072 |
| Loan to Salboy Central Ltd | 42.250 | - | - | 42.250 |
| Partridge Solar Farm | 44.157 | 22.078 | - | 66.235 |
| **Total Corporate Services** | **211.407** | **147.078** | **126.072** | **484.557** |
| **Environment and Transport** | | | | |
| Street Lighting Energy, Carbon & Asset Improvement | 0.559 | 0.550 | 4.950 | 6.059 |
| **Total Environment & Transport** | **0.559** | **0.550** | **4.950** | **6.059** |
| **Growth** | | | | |
| New Bailey | 50.000 | - | - | 50.000 |
| Birchwood Park | 3.885 | - | - | 3.885 |
| Housing Companies | 16.295 | 16.295 | - | 32.590 |
| **Total Growth** | **70.180** | **16.295** | **-** | **86.475** |
| **TOTAL INVEST TO SAVE** | **282.146** | **163.923** | **131.022** | **577.091** |

Table 3 shows the capital financing requirement to 2025/26 for additional borrowing of £701.185 million, with £337.7 million required in 2023/24. All 'invest to save' spend is met from borrowing.

*Table 3: WBC future borrowing requirement (Treasury Management Strategy 2023/24)*

| 2021/22 Actual (£m) | 2022/23 MTFP (£m) | 2022/23 Estimate (£m) | Capital Investment | 2023/24 Estimate (£m) | 2024/25 Estimate (£m) | 2025/26 Estimate (£m) | TOTAL 3 Years (£m) |
|---|---|---|---|---|---|---|---|
| 224.611 | 415.399 | 292.092 | **Capital Expenditure** | 407.662 | 244.305 | 147.381 | **799.348** |
| | | | **Financed By:** | | | | |
| 20.796 | 35.302 | 25.156 | Capital Grants & Reserves | 55.686 | 24.965 | 0.161 | **80.812** |
| 71.786 | 4.490 | 1.806 | Capital Receipts | 10.211 | 0.033 | 0 | **10.244** |
| 0.330 | 0 | 0 | Council Revenue Funding | 0 | 0 | 0 | **0** |
| 9.399 | 7.170 | 2.842 | External Funding | 4.043 | 0.496 | 2.568 | **7.107** |
| **125.773** | **368.437** | **263.092** | **Financing need for year** | **337.722** | **218.811** | **144.652** | **701.185** |

The associated costs of the additional borrowing related to the capital programme is £10.548 million. It is broken down as follows:

- 2023/24: £4.724 million
- 2024/25: £4.665 million

- 2025/26: £1.159 million

In addition, the increase in bank base rate in December 2022 raised the estimated interest rate in the existing capital programme from 4.2% to 4.5%, resulting in increased debt-servicing costs of £314,000. This is funded through additional borrowing.

Consistent with statutory limits determined under section 3(1) of the Local Government Act 2003, the council must set an Authorised Limit for external debt, the maximum borrowing permitted, and an Operational Boundary, the normal level of borrowing expected. The authorised limit for external debt is a key prudential indicator. It reflects the level of external debt which, while not desired, a council could afford in the short term, though not sustainable in the longer term. WBC's assessment of its authorised limits is in Table 4. The council has set its authorised limit at £2,656 million in 2023/24 rising to £2,783 million in 2024/25.

*Table 4: Authorised limit for external debt (Treasury Management Strategy 2023/24)*

| 2021/22 | 2022/23 | 2022/23 | | 2023/24 | 2024/25 | 2025/26 |
|---|---|---|---|---|---|---|
| **Actual** | **MTFP** | **Forecast** | **Authorised Limit** | **Estimate** | **Estimate** | **Estimate** |
| **£m** | **£m** | **£m** | **for External finance** | **£m** | **£m** | **£m** |
| 1647.66 | 2038.75 | 2375.27 | Borrowing | 2653.065 | 2780.205 | 2749.902 |
| 3.638 | 3.343 | 3.193 | Other Long-Term Liabilities | 3.043 | 2.893 | 2.743 |
| **1651.303** | **2042.102** | **2378.471** | **Total Authorised Limit** | **2656.108** | **2783.098** | **2752.645** |

One key affordability indicator is the estimated ratio of the council's general fund capital financing costs to its net revenue stream; essentially, the proportion of the revenue budget devoted to capital financing. Table 5 shows that c.7% of revenue resources is being taken up by capital financing. Given the pressure on council revenue budgets, this could limit the affordability for additional borrowing in future years.

*Table 5: Capital financing cost indicators (Treasury Management Strategy 2023/24)*

| 2021/22 | 2022/23 | 2022/23 | Ratio of financing costs to net revenue stream | 2023/24 | 2024/25 | 2025/26 |
|---|---|---|---|---|---|---|
| **Actual %** | **MTFP %** | **Forecast %** | | **Estimate %** | **Estimate %** | **Estimate %** |
| 5.36 | 7.00 | 6.91 | | 7.00 | 6.86 | 5.83 |

For property investments, the council is 100% indebted. These are explored in more detail in 2.2.

## 3.2 Risks and challenges

### *Financial Position*

The net revenue budget is £188 million. To deliver a balanced budget for 2023/24 the council has identified savings of £13.6 million and used £6.6 million of reserves. There is an identified budget gap to 2026/27 of £64.1 million. £38.9 million of the gap relates to financial year 2024/25. To close it, savings of £7 million have been identified so far.

In 2021/22 and 2022/23 the council achieved savings of £11.6 million and £20 million respectively.

Income from commercial and service investment is £24.3 million in 2023/24, reducing to £20.3 million by 2025/26.

*Table 6: Net income from commercial and service investments as proportion of the net revenue stream (shows non-treasury investment income as percentage of net revenue stream)*

| | 22/23 Estimate £m | 23/24 Estimate £m | 24/25 Estimate £m | 25/26 Estimate £m |
|---|---|---|---|---|
| Commercial Income & Service Investments | 16.331 | 24.365 | 21.527 | 20.268 |
| Net Service Expenditure (NSE) | 157.264 | 183.009 | 177.015 | 190.454 |
| **Commercial income to NSE ratio** | 10.38% | 13.31% | 12.16% | 10.64% |

If commercial and service investment income is not realised, the council has indicated that it would need to reflect this additional funding gap within the Medium Term Financial Plan (MTFP) or apply reserves. Councils' use of reserves is for one-off mitigating measures. WBC's general reserve is held at £4.6 million (4.5% of revenue budget). The strategic investment risk reserve currently stands at £19.2 million as per the 2023/24 MTFP report. (This has been built from an assumed allocation of 15% of the surplus position each year.) Allocating general reserves to meet any ongoing loss of income, after or alongside any use of the strategic investment risk reserve, may not be entirely prudent, since it would limit the council's ability to cover off other challenges.

More detail on reserves can be found in Table 7.

*Table 7: WBC Commercial Reserves Resilience Analysis (provided by WBC during CIPFA review)*

| **WBC Commercial Reserves Resilience Analysis** | | |
|---|---|---|
| | | |
| **Portfolio as at:** | 3/31/2022 | |
| | | |
| **Income** | *Millions* | |
| Commercial income | £23.800 | *Income received from the Council's commercial investments.* |
| **Reserves** | *Millions* | |
| Usable reserves | £120.372 | *Reserves which the Council may use to provide services subject to the need to maintain a prudent* |

| | | *level of reserves and any statutory limitation on their use.* |
|---|---|---|
| Strategic investment risk reserve | £22.203 | *Part of reserves specifically set aside to offset any investment losses or to make backdated voluntary MRP charges. It is built on contributions made each year from investment surpluses.* |
| **Total Reserves** | **£142.575** | |
| **Portfolio** | *Millions* | |
| Total borrowings | £1,653.000 | *Total borrowings comprised of loans from PWLB, the Local Authority Market and corporate LOBO loans.* |
| **Cost of Borrowing** | *Millions* | |
| *Loans to 3rd parties* | £10.243 | *Borrowings related to commercial lending.* |
| *Property acquisitions* | £8.168 | *Borrowings related to the purchasing of properties.* |
| *Other capital schemes* | £13.348 | *Borrowings related to capital Programme* |
| *Fees* | £0.317 | *Brokerage and PWLB arrangement fees.* |
| **Total Borrowing Costs** | **£32.076** | |
| | | |
| **Outputs** | **3/31/2022** | |
| Total Reserves/Net Income | **5.99x** | |
| Total Reserves/Investment Borrowing Costs | **7.61x** | |
| Total Reserves/All Borrowing Costs | **4.44x** | |
| Strategic Reserves/Net Income | **0.93x** | |
| Strategic Reserves/Investment Borrowing Costs | **1.19x** | |
| Strategic Reserves/All Borrowing Costs | **0.69x** | |

### *Minimum Revenue Provision (MRP) risk*

Local authorities should ensure the period over which they charge MRP is commensurate with the period over which their capital expenditure provides benefits.

WBC currently has a gap in MRP provision due in part to its historical application of the annuity method for calculating MRP on commercial investments. This in effect reduced the provision in early years with the charge increasing later. This approach accords with assets for regeneration but not where assets are acquired for yield. In the latter case, the charge should be equal across all years since yielding assets generate returns from point of acquisition. (The council has however provided evidence that a professional assessment for Golden Square shopping centre has been carried out which supports deviation from MRP guidance in that case.)

Where loans are held at amortised cost an Expected Credit Loss calculation should be carried out (and disclosed if material).

There is a risk of a tipping point in later years where MRP becomes unaffordable, potentially driving the council into forced sales. Making MRP provision or creating a reserve to cover possible MRP shortfalls impacts a council's revenue position in the year when funds are set aside. By not making provisions now, a council creates a more favourable short-term budget position by deferring a more challenging one.

WBC has made a backdated MRP charge for commercial property to cover some of the gap. However, there remains the potential of continued MRP gaps in relation to:

- Times Square – void properties are a questionable MRP consideration. Works are complete and the assets are available for use
- Redwood Bank – the council has determined to adopt a 50-year life period for this investment (as opposed to a suggested 20-year term). It has also taken a 5-year MRP holiday on this asset. These decisions may need justifying

We have noted MRP issues across our review work with the affected authorities, including inconsistent, even deviant practice. Policy determinations may be needed, with a clearer line going forward from DLUHC, working with CIPFA, to uphold the guidance.

### *Nature of Investments/Asset Picture and Risks*

The largest growth in WBC's investment portfolio since 2016/17 has been in property. These investments, acquisitions and loan transactions were entered into for yield or regeneration purposes.

*Table 8: Major items of capital spend from 2016/17 to 2019/20 (return to DLUHC)*

| | **Narrative description of high value capex for 2016/17 to 2019/20** |
|---|---|
| **Service delivery** | £25,511 Highways Maintenance Investment. £22,870 Schools. £20,808 Warrington West Station. £20,725 Great Sankey Hub. £18,976 LTP Highways. |
| **Housing** | £105,250 Loans to Housing Associations. |
| **Regeneration** | £539,595 Property Acquisitions. £129,287 Time Square Development. £45,007 Solar Farms. £30,923 Redwood Bank. |

The investments are summarised here in part, to illustrate their level of complexity and attendant risks. The total value of non-treasury investments (as at November 2022) for loans, shares or capital investment purposes stands at £1.249 million.

*Table 9: Council's non-treasury investments (November 2022 Treasury Report)*

| **Non-Treasury Investments Counter Party** | **Balance 31/03/2022 £** | **Balance 30/09/2022 £** |
|---|---:|---:|
| Warrington Sports Holding Ltd | 1,331,375 | 1,331,375 |
| Municipal Bond Agency | 200,000 | 200,000 |
| Warrington Borough Transport Shares | 888,000 | 888,000 |
| Redwood Bank | 14,860,000 | 14,860,000 |
| Birchwood Business Park | 224,937,349 | 243,288,098 |
| Joint Venture with Wire Regeneration | 3,789,971 | 3,789,971 |
| Together Energy | 7,558,520 | 7,558,520 |
| York Solar Farm | 14,718,389 | 16,024,799 |
| Hull Solar Farm | 7,622,454 | 8,432,212 |

| Housing Company (Incrementum)<br>Cirencester Solar Farm | 11,000,000<br>764,358 | 11,000,000<br>764,358 |
|---|---|---|
| **Total Investments in Group Entities** | **287,670,414** | **308,137,332** |
| Loans to Housing Associations & Com<br>Purchase of Investment Properties | 438,285,264<br>391,916,330 | 535,014,924<br>405,942,558 |
| **Total of Non-Treasury Investment** | **1,117,872,008** | **1,249,094,814** |

### *Group Entity Investments (excluding Birchwood Business Park)*

**Together Energy**. The council bought a 50% stake in Together Energy in 2019. In January 2022 due to a combination of factors, Together Energy was put into administration. There is expectation that the council will fully recover the £18.8 million secured debt and is likely to avoid a call on the £29 million guarantee it provided to Orsted, the energy company. It remains uncertain whether the council will recover its £18 million investment in preference shares.

**Redwood Bank**. In 2017 the council purchased a 33% shareholding in a newly formed 'challenger bank', Redwood Bank, at a cost of £30.9 million. In December 2021 shares were sold to a new equity investor, Thurrock Council, at a price of £1.29 per share. Based on this transaction, a 33% shareholding is worth £16.1 million. This has impaired WBC's shareholding downwards to a value of £14.860 million.

Banks of this sort are highly illiquid. Redwood Bank is private and unlikely to go public any time soon – at least not within next 2 to 3 years. To exit its investment, the council would need to work with the bank to identify alternative private investors. There is already an impairment. Short-term exit may not be possible without further losses. Expert advice will be needed to assist the council should it contemplate disposal of its share.

**Warrington Renewables Companies (solar farms).** The council has entered into a partnership with Gridserve to build solar farms. There are 3 currently, in Hull, York and Cirencester. The solar farms also include battery storage. The expectation is for a yield of £150 million over 30 years.

It is hard to predict ongoing income streams at this early stage of the solar project. This creates an element of risk for the initiative. Owing to currently high energy prices, WBC's arrangement secures it both large discounts on energy costs and an income stream from the National Grid for selling surplus electricity. While these types of investments are often deemed risky (and we have found no disposal plans) the market is very volatile and uncertain as we have seen in other councils who have acquired energy companies. We understand that should circumstances lead WBC to consider disposal, for assets of this kind they typically take 6 to 12 months and require the skills of specialist third party organisations to help market and dispose of them. The other disposal consideration is whether the underlying plant and equipment is compliant with new and emerging sustainability requirements. At least one of the three schemes that we evidenced is providing energy to the council through hard-wired connections, so presents a lower risk than where the council is assuming that third party organisations will purchase energy on a long term basis thus securing a long-term source of reliable income.

**Housing Companies: Incrementum Housing Development Company; Incrementum Housing Management Company.** Established in 2019 with £11 million in equity and a £21 million commercial loan, the principal purpose of these WBC companies is to construct then manage high quality, low-carbon housing, thereby also generating long-term income for the council. The homes would be let under a 'fair rent' policy, with 30% of the units being offered at a discounted rent.

There are currently two active developments; Sycamore Lane in Great Sankey and Chatfield Drive in Birchwood, providing 161 new homes, 48 of which will be affordable. The housing has been valued at £31.9 million.

### *Commercial Loans*

**Housing Associations**. The council has been operating a loans scheme to housing associations since 2009 to promote housebuilding and regeneration. Around £480 million in loans is drawn down currently. Lending by the council is state-aid compliant. There is an appropriate mark-up of 1.25% to 1.5% on top of the PWLB rates at which WBC secures the finance. The council also charges a facility fee for access to the loan service whether or not the draw down is exercised. Loans are secured, with covenants. No covenants have been breached to date.

Loans to housing associations seem relatively low risk. They have created an income stream of currently between £8 million to £9 million per annum for WBC. However, the consequent indebtedness is around £920 million. Housing associations are tending not to renew these facilities as loans mature. The impact of this should be reflected in the MTFP's longer term view so the council can plan well in advance based on maturity dates.

WBC may find it difficult to offload these arrangements outside of loan maturing dates with the housing associations unless the loans can be transferred to another party to take on, enabling the council to repay its borrowing early.

**Business Regeneration Schemes**. WBC has given a fully secured loan to The Hut Group to promote economic regeneration. The loan, negotiated on a full commercial basis, is a £202.133 million facility for 8 companies over 7 years with an interest rate of 4.7% (4.5% on the Manchester Airport office due to lower Loan to Value). There is a 1% (£2.2 million) arrangement fee and a 0.7% (£70,000 per million) commitment fee.

The council will need to manage this loan well. This income stream is built into the MTFP. Early payback of a loan (as was recently requested) would reduce the debt equity ratio.

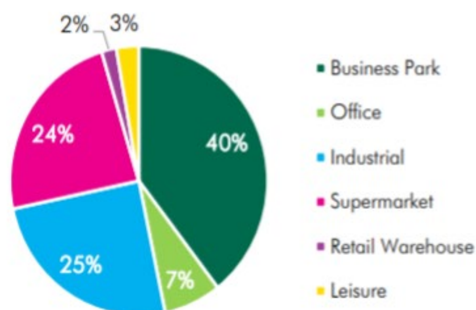
### *Property Investment Portfolio (including Birchwood Park) Asset Values c.£598 million*

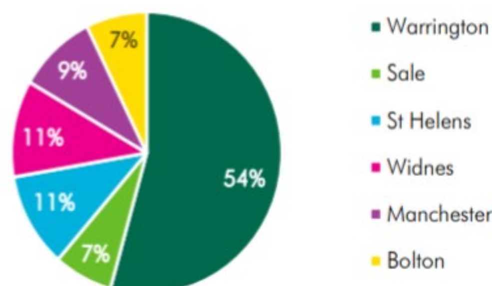
Since 2016 the council has acquired 14 investment properties (and Birchwood Park). 7 (including Birchwood Park) are in Warrington, the other 7 are in the North West region. The properties include distribution and logistics units, supermarkets, offices and industrial buildings, with some leisure and non-food retail. These provide the council with a commercial rental income stream. Third party reviewers will compare local rents against similar types of properties in neighbouring towns and will also compare and contrast with a wider national perspective too.

Market valuations are carried out at least every 12 months for all properties. Capital growth is 11.4% higher than the aggregate price paid on acquisition for the portfolio. The council states that this reflects the weighting of the portfolio towards supermarkets and logistics rather than retail and leisure, which have suffered in the recent economic climate. Over 95% of rent collected is for Birchwood Park. Rent due and collected for the rest of the property assets is 100%. Table 10 shows the portfolio structure and is followed by an illustrative graphic produced by CBRE (broadly proportionate, though produced at a different moment.)

*Table 10. Property portfolio structure (information provided to DLUHC)*

| Type | Historic Cost - property purchase price £ | Fair Values (March 31st 2022) £ | 2022/23 Rental Income (forecast) £ | 2023/24 Rental Income (forecast) £ | 2024/25 Rental Income (forecast) £ |
|---|---|---|---|---|---|
| Leisure | 1,800,000 | 2,000,000 | 112 | 146 | 146 |
| Logistics | 111,045,000 | 122,950,000 | 998 | 1,017 | 1,246 |
| Misc | 33,900,000 | 29,100,000 | 1,127 | 1,127 | 883 |
| Office space & Warehouse | 211,000,000 | 237,390,000 | 1,199 | 2,591 | 3,498 |
| Retail | 10,900,000 | 10,350,000 | 410 | 410 | 410 |
| Supermarket | 168,350,000 | 196,150,000 | 2,707 | 2,866 | 3,293 |
| **Grand Total** | **536,995,000** | **597,940,000** | **6,554** | **8,157** | **9,476** |




The majority of office space and warehousing is set within Birchwood Business Park. This was acquired for £211 million in 2017 via a Jersey Property Unit Trust (JPUT), a tax-efficient offshore mechanism. The Park is a large, mixed-use property, comprising office and industrial accommodation. Space is let on 225 leases and licences. The asset is held in the JPUT and the council receives income from the property by way of a quarterly distribution.

Table 11 is an extract from the CBRE report illustrating what are in the main very low risk property lettings. This correlates with their relatively low yields.

*Table 11: CBRE report extract*

## Portfolio Analysis (continued)

### Top Ten Tenants Direct Commercial Portfolio (by Contracted Income)

Birchwood Park accounts for a total of 225 occupational leases and licences. Excluding Birchwood Business Park, the portfolio is let on a total of 21 occupational leases. DW Sports, Mersey Street, Warrington has been excluded for the purposes of this report. The top ten tenants – excluding Birchwood Business Park – account for 94.3% of the gross income. Upon completion of the acquisition of New Bailey, there will be a second lease to British Telecommunications PLC in place. The rent is still to be confirmed.

**Top Ten Tenants (by Contracted Income)***

| No | Tenant | Asset Sector | Number of Leases | Gross Contracted Income (£ pa) | % of Portfolio Gross Income* | Risk Rating (Experian) |
|---|---|---|---|---|---|---|
| 1 | Tesco Stores Limited | | 2 | 4,754,224 | 30.4% | 100 / Very Low Risk |
| 2 | Movianto UK Limited | | 1 | 2,333,969 | 14.9% | 82 / Low Risk |
| 3 | Asda Stores Ltd | | 2 | 1,985,000 | 12.7% | 99 / Very Low Risk |
| 4 | Sainsburys Supermarkets Limited | | 1 | 1,819,088 | 11.6% | 78 / Below Average Risk |
| 5 | Eddie Stobart Limited | | 2 | 1,249,963 | 8.0% | 80 / Below Average Risk |
| 6 | British Telecommunications PLC | | 1 | 1,014,284 | 6.5% | 100 / Very Low Risk |
| 7 | New Balance Athletic Shoes (UK) Limited & Warrior Sports UK Limited | | 1 | 490,656 | 3.1% | 35 / Above Average Risk |
| 8 | Matalan Retail Limited | | 1 | 480,000 | 3.1% | 96 / Very Low Risk |
| 9 | Highways England Company Limited | | 1 | 352,500 | 2.3% | 100 / Very Low Risk |
| 10 | Travelodge Hotels Limited | | 1 | 271,095 | 1.7% | - / Maximum Risk |
| | | | 13 | 14,750,779 | 94.3%* | |

Performance of the portfolio is monitored on a weekly basis by Chartered Surveyors in the council's Property and Estate Management (P&EM) team. The council has also appointed external national Chartered Surveyor firm CBRE to advise and report on investment performance and asset management of this portfolio. This excludes Birchwood Park. CBRE provides a quarterly written report on the performance of the portfolio with a comparative analysis against typical property investment portfolios in the UK.

There are also two fortnightly technical officer group meetings (one is specifically for Birchwood Park) reviewing the investments, performance and risk, and a quarterly council Investment Performance Group chaired by the Chief Executive.

Each individual asset has its own business plan to ensure both strategic and day-to-day management matters are addressed and reviewed. This includes ongoing rent reviews a, regearing and lease reviews. This should also include an assessment and review of risks for each property to inform decisions around lease options, tenant relations and disposal strategy. We did not have the time to assess the effectiveness of the business plans. However, from our interviews we are aware that there are constraints on officer time. External advisors are providing information on credit worthiness of tenants and changes in guarantors. There is further work required to ensure tenants are engaged well in advance of lease expirations. These relationships need to be actively managed. Though the council is starting to consider disposals more seriously, there is no disposals strategy as such and no overarching assessment of the property portfolio and associated risks.

In order to cover the costs of borrowing, the council requires property to be occupied with paying business tenants and seeks growth in asset value. The highest risk to the portfolio is assessed as the impact of current economic uncertainty on business and on property values (rent and capital value).

The strategy to borrow and hold property for the long-term fits a yield model. When the council acquired much of its property portfolio, borrowing for yield was an allowable practice in local government. It is the view of CBRE that WBC property investments are held on the

basis of yield. Currently no assets have been deemed disposable as a result; the strategy was to achieve income and hold assets long term.

Low risk yields would be expected to be on average around 3.5% per property based on an industry average. Table 12 shows that the yield total for the size of the portfolio investment is relatively low at 1% to 2%, primarily as result of low yield properties in Birchwood Park. Such low portfolio yields raise the question of whether £411 million of property indebtedness makes sense. Disposal could take anywhere between 6 to 18 months depending on their complexity and owing to the need to move cautiously on some deals to avoid a fire sale effect.

The council's advisors have informed us that the levels of risk involved, given tenancy and property quality, is low. The lower net yields reflect that level of risk.

A regeneration model is better supported through lending rather than through equity creation. This enables market intervention through build, exit and recycling of cash for the next intervention. Having a clear exit strategy for regeneration assets is essential.

*Table 12: Net Yields – rental income/historic property cost (WBC information to DLUHC)*

| **Property** | **Yield (forecast) 2022/23** | **Yield (forecast) 2023/24** | **Yield (forecast) 2024/25** |
|---|---:|---:|---:|
| Apollo Park | 6% | 8% | 8% |
| ASDA Hulme | 4% | 4% | 4% |
| Birchwood Park | 1% | 1% | 2% |
| Decathlon | 1% | 1% | 1% |
| Highways England/New Balance | 3% | 3% | 1% |
| Matalan | 4% | 4% | 4% |
| Movianto St Helens | 2% | 2% | 2% |
| Pure Gym | 1% | 1% | 2% |
| Royal Mail Omega | 3% | 3% | 3% |
| Sainsbury Sale | 2% | 3% | 3% |
| Stanford House | 1% | 1% | 2% |
| Stobart HQ | 0% | 1% | 1% |
| Tesco Farnworth Bolton | 4% | 4% | 4% |
| Tesco Widnes | 0% | 0% | 0% |
| **Total** | **1%** | **2%** | **2%** |

**Commercial income indicators** (data source: Treasury Management Strategy 2023/24) The indicators A to D below consider the size of debt and the level of income from investments compared to gross and net annual revenue budget, as well as the level of interest coverage compared to annual income received from property.

*A: Debt as a percentage of net service expenditure (NSE)*

This indicator shows gross debt as a percentage of WBC's net service expenditure, essentially the level of debt relative to the Council's financial size and strength.

*B: Commercial Income as percentage of NSE*

This indicator shows the dependence on income that is not from fees and charges. Fees and charges income is netted off the NSE and compared to non-fees and charges income. Commercial income in this case refers to net interest and fees from loans to housing

associations and other commercial entities, plus gross rental received from commercial property investments as identified in the MTFP.

*C: Interest Cover Ratio*

This indicator shows the ratio of estimated net income from commercial property before interest and MRP compared to the estimated interest expense incurred by them.

*D: Loan to Value Ratio*

This indicator compares the amount borrowed against the value of the commercial property assets bought. All Council Invest to Save Schemes are 100% loan to value and interest is charged on the full amount of the purchase price and associated costs.

*Table 13: Commercial income indicators A to D*

| **A** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
|---|---|---|---|---|
| Gross Debt | 1853.147 | 2159.343 | 2347.974 | 2463.557 |
| Net Service Expenditure (NSE) | 157.264 | 183.009 | 177.015 | 190.454 |
| **Gross Debt to net service expenditure ratio** | 1178.37% | 1179.91% | 1326.43% | 1293.52% |
| **B** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
| Commercial Income MTFP | 25.201 | 26.200 | 38.093 | 35.401 |
| Gross Service Expenditure less Fees and Charges | 285.117 | 273.870 | 272.440 | 270.870 |
| **Commercial income to NSE ratio** | 8.84% | 9.57% | 13.98% | 13.07% |
| **C** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
| Net Commercial Property Income before interest | 26.588 | 31.085 | 31.555 | 31.655 |
| Commercial Property Interest | 15.051 | 17.499 | 18.615 | 18.675 |
| **Interest cover ratio (times)** | 1.77 | 1.78 | 1.70 | 1.70 |
| **D** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
| Gross Debt related to | £656,354 | £700,354 | £700,354 | £700,354 |

| | | | | |
|---|---|---|---|---|
| Property investments | | | | |
| Commercial Property Purchase Costs | £656,354 | £700,354 | £700,354 | £700,354 |
| **Loan to Value Ratio** | 100.00% | 100.00% | 100.00% | 100.00% |

For these investments, WBC relies on the cost of borrowing being less than the income it receives. It also uses favourable interest rates to provide an income source. Should interest rates became less favourable or property income reduce by 1.7%, WBC would be in a negative income position and would need to mitigate it. In the short term the expected mitigation would be the use of reserves. Medium term the council might need to factor such adversity into its MTFP and cut spend on services, reduce borrowing through disposal of assets, applying capital receipt to transformation activity, or seek alternative more favourable investments. The last recourse would be more difficult to argue under current regulatory conditions, since it would likely be construed as seeking yield.

The indicators E to F below show the yield (financial return) from property investments.

*E Target Income Returns*

This indicator measures the yield for the property portfolio. It compares net income received, before interest and MRP, to purchase costs. This is shown in totality for the whole of the portfolio. Purchase costs are the total for the portfolio not just new purchases. E1 shows the measure after MRP but before interest, E2 after both MRP and interest.

*F Gross and Net Income/Operating Costs from Commercial Investments*

This indicator shows expected gross income received from commercial property activities, the operating costs of running them, and the resulting net income in monetary terms before and after interest, and also after MRP.

Please note for gross commercial income, the Birchwood Park income figures used are before costs deducted within the Trust. These are included in operating costs although they are not Council expenditure.

*Table 14: Yield indicators*

| **E** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
|---|---|---|---|---|
| Net Commercial Income from Property Investments before interest and MRP | 26.588 | 31.085 | 31.555 | 31.655 |
| Commercial Property Purchase Costs | 656.354 | 700.354 | 700.354 | 700.354 |
| Target Income Returns | 4.05% | 4.44% | 4.51% | 4.52% |

| E1 | 22/23 Estimate £m | 23/24 Estimate £m | 24/25 Estimate £m | 25/26 Estimate £m |
|---|---|---|---|---|
| Net Commercial Income from Property Investments before interest but after MRP | 20.760 | 25.065 | 25.048 | 24.964 |
| Commercial Property Purchase Costs | 656.354 | 700.354 | 700.354 | 700.354 |
| **Target Income Returns** | 3.16% | 3.58% | 3.58% | 3.56% |
| **E2** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
| Net Commercial Income from Property Investments after interest and MRP | 12.126 | 14.416 | 12.833 | 12.589 |
| Commercial Property Purchase Costs | 656.354 | 700.354 | 700.354 | 700.354 |
| Target Income Returns | 1.85% | 2.06% | 1.83% | 1.80% |
| **F** | **22/23 Estimate £m** | **23/24 Estimate £m** | **24/25 Estimate £m** | **25/26 Estimate £m** |
| **Gross Commercial Income from Property Investments** | **33.005** | **37.935** | **37.955** | **37.955** |
| Operating Costs | 6.417 | 6.850 | 6.400 | 6.300 |
| **Net Commercial Income from Property Investments before interest** | **26.588** | **31.085** | **31.555** | **31.655** |
| Commercial Property Interest | 15.051 | 17.499 | 18.615 | 18.675 |
| **Net Commercial Income from Property Investments after interest** | **11.537** | **13.587** | **12.940** | **12.980** |
| MRP | 5.828 | 6.020 | 6.507 | 6.691 |

| **Net Commercial Income from Property Investments after interest & MRP** | **5.709** | **7.566** | **6.433** | **6.290** |
|---|---|---|---|---|

With all costs of financing capital investment taken into account, the yield is around 1.85%. (Note the property costs and rental income figures used for these indicators, derived from the Treasury Management strategy cited, are higher than those provided to DLUHC and used in Table 12.)

Given WBC's indebtedness, the risks associated with investment holdings and the MTFP financial gap from 2024/25 onwards, it is important to consider the council's ability to liquidate its investments. This is especially pertinent since the yield is not particularly high. WBC's position in their Treasury Management Strategy for 2023/24 states:

*"Currently our property advisors CBRE due to the current state of the national current property market do not advise selling any property assets currently. Our loan portfolio is for economic regeneration purposes and has performed well since 2009 and there are no material risks factors of exiting it. Our solar farms are performing well and with an increased emphasis on climate change and energy security currently the Council has no plans to exit currently. Birchwood Park is a property asset and per the Prudential Code the Council will need to borrow to fund the maintenance and development of the Park over the next 3 years. In 2023 a 3-year business plan will be presented to Cabinet on the development of the park and the associated borrowing implications for the Council."*

## 3.3 Conclusions

The foregoing analysis of WBC's investment/indebtedness position suggests a number of potential risks relating to a range of matters. These include the potential interactions of the portfolio with the MTFP. All such portfolios are vulnerable to interest rate fluctuations and market volatility. These volatilities may be especially unpredictable in some areas of the WBC commercial ventures, such as the energy companies. We have noted the impairment to the bank shares. Some commercial yields, in parts of the property portfolio for instance, are relatively low, suggesting the need to look at other options to protect the council's revenue position, including disposal (which we know the council is now considering). Where the portfolio is retained, there may be a need to review MRP policy. The current approach to funding the risk reserve may need attention over the longer term to insulate against income fluctuations and repurposing.

Indeed, the assumptions underpinning the existing property investments may need revisiting, given the much-changed regulatory and market conditions since they were acquired. The WBC property investment strategy states that WBC seeks "To take advantage of current property values and to seek long term (20 years) capital growth". This approach plainly depends on sound longitudinal analysis and constant vigilance. It is also arguably best suited to yield investments, now less permissible to councils.

But the most striking feature of the portfolio is its very size, mix and complexity. Managing this would present an exacting challenge to any local authority finance team and leadership.

In their recent audit findings report, the external auditors took the following view:

*"We remain of the view that debt of over £1.6 billion as well as the limit of 23.3% on commercial income as a percentage of budget is not affordable, prudent and sustainable*

*over the long-term for the Council. We consider that setting the limit of commercial income as a percentage of budget based on the reduction in government funding is an arbitrary way of setting this limit. It does not demonstrate that such a level of commercial income is sustainable or that the underlying debt is affordable.*

*"There are many risks with the current strategy, which could impact on the Council's ability to demonstrate value for money over the long-term as well as risks to security of some the funds. Many of these risks are laid out in the Council's Capital Strategy in generic terms even if not specifically applied to individual investments. The Council is more exposed to the consequences of this risk than most other local authorities as a result of its investment activities in the last few years.*

*"We raised two recommendations to address the weaknesses in its arrangements. We recommended that the Council should:*

- *improve the clarity of its reasoning in the Capital Strategy to depart from the applicable guidance with a clear explanation why the Council considers that the level of risk is acceptable.*
- *commission an external review to assess the affordability, efficacy and sustainability of the Council's Capital Strategy over the long-term and to evaluate proportionality in terms of debt and commercial income as a percentage of budget."*

It is in part to move on from this cycle of reviews and into a position of greater clarity, strategic certainty, and financial defensibility that we have recommended our way forward. Before we consider that, however, it is worth examining the capacity, decision-making and governance realities in WBC.

# 4 Investment/debt management resources

## 4.1 Internal teams

Lead members of the administration and the Chief Executive argue strongly that their internal teams have the capability to oversee the council's investment portfolio. There are also contrary views. It is not our role to arbitrate. Rather, our aim is to be constructive and highlight potential risks and opportunities for improvement.

We have certainly seen evidence of considerable officer capacity in WBC for the management of the debt/investment portfolio. And we have been assured that corporate capacity has been expanded to meet the challenge.

We have also met experienced senior professionals. The Section 151 officer (S151) oversees a team that is very active in the council's commercial business. He acknowledges that the effort required takes up a significant amount of his time and that of other officers. He would reject, however, any suggestions made in some quarters, that the burden of this responsibility distorts the finance function or unduly distracts it and the wider council from more day-to-day business. The Head of Corporate Finance appears to have extensive responsibilities in respect of the investment portfolio, while the Deputy S151 officer seems focused more on the Council's service operations. Some interviewees have characterised the S151 and Corporate Finance Head as controlling, even initiating the debt/investment agenda. This was pointedly rejected by them and others, with the approach being described as strategic and member led.

While the portfolio has challenges and complexities, some elements are deemed comparatively self-managing. Loans to housing associations, for instance, receive limited review from the finance team and take up little officer time. This is the largest single area of WBC indebtedness at almost £1 billion. There appears to have been no assessment of whether loans will be fully repaid, with the council reliant on past history for confidence about defaults and the security of collateral. However, the risks appear relatively low for a reasonably assured, if modest, return. Moreover, housing associations are tending not to renew these facilities as loans mature. So this area of indebtedness may start to decrease appreciably. We recommend that the council undertakes a piece of work to model a small range of scenarios regarding loan payback. The output of the modelling will allow the council to examine the impact on its repayment schedules, risk profile, capital financing requirement and MRP.

The Head of Legal, an experienced litigator, acts as the Monitoring Officer and is also involved, as part of the senior leadership team, in many aspects of commercial decision-making. The extensive property responsibilities are split between the Acting Head of Property and Estate Management, and the Head of Growth. The former manages the existing portfolio of properties, including commercial properties, the latter is engaged in regeneration and also helping to assess new opportunities. (In section 2.2, we noted challenges facing the P&EM team, which is also not currently discharging the corporate landlord function, though it has ambitions to do so.)

When we asked these various senior officers whether the commercial portfolio and associated debt had been arrived at through 'line by line' accumulation or as part of a strategic plan, they universally referenced the points we have recorded in section 2.1.1 (i.e., commercial and entrepreneurial thrust of Government policy, council's desire to support the local economy. promote social wellbeing and to generate sustainable income streams for WBC). While this rationale is comprehensible, we are less certain that there is an absolutely clear articulation of the future strategic role of this portfolio or the Council's forthcoming

intentions for it, especially in the context of changing economic, regulatory and geopolitical conditions. Given our earlier comments on the seemingly piecemeal approach to the development of WBC's commercial portfolio and reflective of the current economic conditions including a number of major local authority failures in this area, we recommend a fresh articulation of the Council's commercial strategy and associated risks and for this to be undertaken as soon as possible.

It was suggested to us in some quarters that the balance of council business was skewed by the demands of the portfolio. This was denied by most senior officers. However a lead member suggested that with the benefit of hindsight, particularly as the effectiveness of the investment approach potentially recedes, it might have been better to be in a more advanced position on other initiatives to achieve financial and service stability. We cannot comment on this observation. Going forward, however, there is certainly an opportunity for the balance of strategic approaches to WBC sustainability to be examined.

We were certainly impressed by the fluency, even slickness, with which aspects of the WBC investment and property machine work. However, we noticed an occasional lack of taxonomic and category clarity about the purpose of investments. For example, an interviewee might characterise the whole portfolio as 'commercial investment'. Yet when challenged about this terminology, given the limited overall yield, they might point to elements within it that were never intended to be considered commercial. We also heard the same initiative being described as fundamentally about yield in one quarter and fundamentally about regeneration in another.

This may seem a trivial matter. We do not believe it to be. The conspicuousness of the WBC debt-funded approach, its outlier status for investment holdings and indebtedness, together with the now more restrictive regulatory conditions on borrowings for yield, place particular burdens of communication and justification on the council. Greater clarity would help that justification and would also underpin the articulation of the strategic purpose. In the course of our programme of reviews, we have noted that some of the high-debt authorities can appear on first view to be venture capitalist concerns running a social enterprise – the council – on the side. Clear taxonomy on the distinctions between and differing legitimacy of various investments might neutralise this perspective. It would also help contextualise the Council's important arguments about the revenue funding scarcity it faces.

The changed regulatory conditions here are particularly significant. In common with other authorities that have made successful ventures into property, Warrington is now frequently approached by commercial concerns who make proposals for investment. The council is clear that it does not accept allcomers, with only around 1 in 10 approaches being progressed to business case stage. But with yield now off-limits as a justification for borrowing, the council will need to ensure that in any future investment activities, as well as in its asset retentions, it is strategically clear and defensible.

Moreover, the council's approach to a variety of matters, as diverse as housebuilding, commercial lettings or the availability of loan finance for local business, can almost look like a 'propensity to intervene'. The council is very committed to the local economy. We have heard arguments to the effect that without its direct activism, there would be market failures. Commercial landlords would not let to the right sorts of tenants. A bank would not locate to Warrington. Houses would not be built in volume and to spec. We have no doubt that in the instances cited, the cases for intervention were made robustly, honestly and comparatively. But we also know of examples of councils achieving high-bar economic and regeneration outcomes through partnership working, without the exposure of ownership. We note and accept, of course, that WBC has indicated that it always examines alternative approaches to investment interventions. But as debt-funded options for pursuing its objectives grow

more challenging, the need for WBC rigorously to consider other approaches may become even more important.

Moreover, the idea of an essential and unavoidable intervention could potentially have a constraining effect on disposals if the council's perceived irreplaceability endures, especially where time-limits and exit conditions for interventions are not set. At present, the council's approach is to assess disposals on a case-by-case basis. Going forward, a more concerted strategy will be needed, which WBC seems to acknowledge, itself pointing to instances where asset retention is starting to make less sense than previously.

But once again, without question, the most striking thing about the capacity and skills challenge of the portfolio is its scale and complexity.

At the line-by-line level, there seems to be detailed scrutiny and business case assessment, supported by externally sourced specialist advisory capacity, on legal matters, financial services, M&A, taxation and so forth. Staff also receive training. 29 internal staff across Finance, Legal and Property, including the S151 Officer and the Monitoring Officer, have been trained for tax, green energy, estates and housing. This combination of in-house and non-council capability and capacity is essential. It should be kept under constant review, given the complexities at the level of individual projects, which impact on council officers' work. In property there are issues associated with market conditions, interest rates, valuations, rent reviews, tenant management, condition surveys, asset upkeep and so forth. Redwood Bank and the energy companies are highly specialised matters. The banking sector in particular is characterised by notoriously voluminous and opaque contracts and complex regulatory information, which the Head of Internal Audit suggested were beyond the current comprehension of his team to advise on.

But the management of a large portfolio is a constant challenge. Its moment-by-moment micro-adjustments, the mutual dependency of its elements and their collective impact on revenue budgets constitute a substantial – perhaps intractable – combined responsibility.

The acceptance of the principle that WBC needs expert aid at the level of individual investment initiatives is sound. The management of the investment *entirety* would also benefit from external input.

*The role of internal audit*

The Head of Internal Audit is undertaking a review of the function, with a review due to go to the Audit and Corporate Governance Committee. Historically, its role in the investment sphere has been fulfilled through the presence of the Head of Internal Audit and their team on review groups and committees. This has led in the past to some challenges, for example, around retail returns and the loan to the Hut Group. However, the audit team's effectiveness has, in the view of the Internal Audit Head, been constrained by issues of remit and knowledge.

The findings of the APAM review may prove instructive. They may also have a bearing on where the assurance role provided by internal audit fits into our wider recommendations about expert support.

## 4.2 Access to non-council expertise

As indicated, the council engages numerous external advisors. We have provided a list of some of them below.

We have spoken to several specialists and their feedback has been useful. We have not been able to assess them in terms of quality or value for money. As a general point, though,

when sourcing expertise of this sort, on which WBC is especially reliant, good procurement practices – quality assured supplier lists, rotation and so forth – are extremely important.

*Legal advisers*
Property – TLT LLP
Solar – Geldards LLP
Together Energy – DAC Beachcroft
Incrementum – Acuity Law

*Project Management and Cost Consultancy*
Baker Mallett LLP

*Valuations*
Knight Frank

*Finance*
Link Group
Camdor Global Advisors

Ernst & Young
KPMG LLP
Baringa
PwC
Traderisks
Gresham House
CBRE
Jones Lang LaSalle Limited

## 4.3 Decision-making, oversight and governance

Warrington Borough Council is controlled by a majority Labour administration. It operates the Cabinet/Scrutiny system. We spoke to senior members of the administration and members of the Conservative opposition. We want to put on record how impressed we were by the sincerity and commitment to Warrington we found in all the councillors we met. It is very important to make this clear, since the perspectives we encountered were frequently at odds.

Administration members asserted that the council's agenda is theirs and rejected the imputation of an 'officer-led' approach on investments. We certainly found evidence of extensive involvement of members in oversight groups, policy bodies, and various officer/member fora examining investment and regeneration issues. We were also advised of extensive member training on these matters.

The perspectives of the opposition were less positive. They felt that their dissenting perspectives and critiques of the assumptions in reports, especially evident in their contributions to Audit and Corporate Governance Committee, were unwelcome. They considered scrutiny ineffective and partisan, and noted what they considered the overuse of part 2 (i.e., those items of a commercially sensitive and confidential nature normally excluded from the public and such items as set out as exempt information in Section 12A of the Local Government Act 1972) agenda items.

Again, it is not for us to adjudicate. We were impressed by the seriousness of administration members. But we also believe that it is essential that opposition councillors feel they can hold the administration to account. That includes them having the latitude to call into

question a whole range of matters, from major investments to the policy assumptions underpinning the council's Treasury management approach.

We note that the council has been subject to a recent governance review related to debt/investments. To build on this work, and to support the Head of Audit's belief that the Audit and Corporate Governance Committee can be an effective locus for scrutiny and challenge, WBC could benefit from a practice we have seen working effectively elsewhere. It could comprehensively map its governance and decision-making processes. The precise roles of the formal and informal structures, the sequencing of their involvement, and the opportunities for open challenge, could be set out. It might be useful as part of this to look at the roles of the governance structures for the council-owned companies, how their boards are filled, and the accountability and oversight the arrangements achieve.

## 4.4 Conclusions

We have observed strengths in the officer cadre. We have noted the sensible use of external expertise. We have encountered a strong grasp of relevant issues among administration lead members. We have heard a robust defence of WBC's approach.

We have also heard highly critical perspectives and we have certainly found evidence of areas where improvements could be made.

In these circumstances, it is a frequent failure in review work to make the ultimate 'cop out' recommendation: that another (slightly differently specified) review is needed. Our advisory predecessors on the Warrington scene do not seem to have been immune to this consulting affliction, though in their defence, the issues in play are very complex.

In section 4, we suggest a way of breaking out of this cycle of review upon review.

# 5 Recommendations

As indicated at the outset, the scale and complexity of WBC's debt/investment portfolio means that a 31-day project only scratches the surface.
Until the debt reduces, Warrington will remain conspicuous, even if the council weathers other related pressures, such as projected revenue gaps in the MTFP.

WBC lead officers recognise that their outlier status places on them a particular onus of justification. We have also heeded WBC's point that the driver for this status is, in part, the impact of the local government funding formula on the council. This is plainly beyond the scope of our study. But we believe it to be a relevant consideration for engagement between DLUHC and WBC, especially in the context of our overarching recommendation.

The fieldwork has highlighted a number of potential issues. The taxonomy and classification of investment portfolio elements by purpose could be sharper and we recommend that the council re-frames its commercial strategy with more emphasis on clear categorisation of investment linked to key outcomes (financial, commercial, social etc). At the same time, the council should assess the key medium to long-term risks against each of its major investments. We have mentioned an apparent, though disputed, 'propensity to intervene' and the need for a more concerted approach to disposals, which WBC sems to be engaging with seriously but again their disposals strategy needs to be anchored to a revised commercial strategy.

There are numerous processes in place for decision-making, governance and oversight of individual projects. We have heard representations from some members criticising these arrangements, suggesting an officer-led agenda, characterised by overuse of part 2 reports and discomfort with dissent. And we have heard robust rebuttal of these views by lead officers and members of the administration. It has been suggested that the investment portfolio unbalances the authority, requiring a substantial staffing, significant expenditure on external experts, and lots of management attention at the expense of engagement with more day-to-day council business. Again, such suggestions have met flat repudiation by lead officers and members.

It is not for us to referee these disputes, and our work is time limited. However, we do believe there are issues that require lasting resolution and we have proposed an approach to achieving this. Our recommendations are set out below:

| Recommendation number | Recommendation description |
|---|---|
| 1 | **Independent Investment Advisory Panel**<br><br>We recommend that WBC and DLUHC agree to the appointment of an **independent investments advisory panel**. The panel should be in place for a term, perhaps initially of 24 months, with an option to renew. As well as advising WBC and the Department in more detail on the issues touched on in this report, while remaining independent from them both, it will provide expertise for the council. It will assist WBC in managing its complex portfolio.<br>The panel should comprise a mix of full-time and part-time resources and conduct as much of its work as possible in person in Warrington. |

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| | in our view the composition or terms of reference for the panel, which will be a matter for WBC and DLUHC to determine. We are nevertheless ready to assist both parties in developing this resource. Certainly, financial skills of the sort found among people with senior Treasury, Bank of England or City experience, or with backgrounds in commercial contracts 9eg those with practical contract experience, will be useful here, supported by local government finance professionals. But the detail should be left up for discussion.<br><br>However, as a minimum, we consider that it would be sensible for the panel or its nominated members to:<br><br>Work with senior officers to develop a workplan of improvements and to ensure the effective operation of the council's commercial portfolio for the next 12 months. This approach has the benefit of lifting key recommendations and the surfacing of other issues in this report into a more integrated and focused planning approach.<br><br>• including attending both officer and councillor/officer policy development, oversight and decision-making sessions. This will allow the panel to understand the policy origins of investment decisions and see at first hand WBC's management capacity and expertise<br><br>• Including making any recommendations related to officer capacity or member/officer decision-making based on their observations<br><br>• provide expert advice on investment portfolio management, including:<br>    o Taxonomy and classification, making the types of investments clearer and categorised into a more integrated commercial strategy<br>    o The development of strategic principles for each investment area (e.g., energy, housing, commercial property)<br>    o The development of KPIs including an early warning system and other such triggers to ensure that changes to market conditions can be quickly analysed and impacted to protect the council from further financial exposure.<br>    o The sourcing of highly specialised advice and support<br>    o Ad hoc advice<br><br>• support the development of an orderly approach to disposals<br><br>On this last point, we believe that WBC, DLUHC and the advisory panel should agree some shared principles and a timescale. The principles should include assessment of the potential short, medium and long-term benefits for the revenue position from disposal, while the timescale might set out an indicative period for a reduction in the scale of indebtedness. This might be, for example, halving it over say a 7 to 10 year period.<br><br>For the panel to be effective, we believe that for at least the first year of its operation, WBC should accept limitations to its |

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| | investment plans, similar to those that are being adopted elsewhere across this review programme. To that end, we believe it will be appropriate for WBC, DLUHC and the panel to agree from the outset the terms of a moratorium on the accumulation of any additional investment-related debt.<br><br>We note again that we have floated this idea in general terms with senior officers, members, and other stakeholders in Warrington. It has received widespread support. The precise details, governance and any associated communications will warrant careful attention. But we are confident that if adopted, this approach could be enormously beneficial. |
| 2 | **Commercial portfolio dashboard**<br><br>We are mindful of the concerns raised by the external auditors with regard to the current lack of a holistic analysis of the investment portfolio. We recognise the work done to improve reporting but recommend that the council create a single dashboard or 'commercial performance pane' through which all key commercial interests can be viewed and managed. The commercial dashboard should then form an integral part of the council's performance monitoring regime. This would then enable the council to have a single view of all its commercial risks and KPIs including levels of borrowing and returns in one place. Within 3-6 months. We consider this recommendation be addressed as a matter of urgency. |
| 3 | **Audit Committee**<br><br>The Audit Committee have not always been able to provide robust and consistent challenge to the council's commercial interests and we have found that Internal Audit lack specific commercial and financial skills to provide effective challenge which would, ordinarily, lead to a more insightful and focused surfacing of issues and challenges – this is in comparison to what we see in the private sector regarding commercial investments where the private sector have a consistent and robust approach to assessment and challenge of commercial investments bringing rigour via an evidence-based approach.<br><br>Whilst we have acknowledged that member training (in the area of commercial interests) is good and accepting that the council has a strong skills base to manage the commercial portfolio both at senior and practitioner levels, we recommend that the council objectively review whether the total skills and competency base is fit for purpose against a revised and re-cast commercial strategy. We also recommend that the council nominates a single officer that can help orchestrate such a review and, subsequently, monitor the council's commercial skills/competence on an ongoing basis. |
| 4 | **Council focus on core business versus commercial portfolio**<br><br>We are not convinced that the council has all of the required skills, capacity and competencies required to run the council's core business while at the same time focusing on the management of what is a complex and diverse commercial portfolio. We recommend that council undertakes an objective review of all |

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| | aspects of its capacity drawing on best practice from the sector (see our commentary in Section 3). |
| 5 | **Risk based analysis**<br><br>We would recommend the need to undertake further and more detailed analysis of the issues raised in this report to identify the full impact of all the commercial activities of the council against the current budget and MTFS. Because at this stage we are not confident that the council has fully assessed these factors. The outcome of this review will enable the council to impact-assess any immediate of near-term detrimental effect on the council's overall financial situation. We consider this recommendation be addressed as a matter of urgency. |
| 6 | **Scenario modelling**<br><br>We recommend that the council undertake some focused scenario planning work to inform them of positive and negative impacts on the MFTP including their overall indebtedness and the effect on income streams from their investments in future years. We recommend that such scenarios are developed using skills and experience drawn from external third party organisations to maximise objectivity. We consider this recommendation be addressed as a matter of urgency. |
| 7 | **Impairments**<br><br>We recommend that the council continues to assess whether it should be making further impairment decisions within its commercial portfolio. For example, we suggest that the dilution of the council's share in the Redwood Bank is an immediate impairment issue (see our commentary on the Redwood Bank in Section 2). |
| 8 | **Expected credit loss**<br><br>On the basis that local authorities should ensure the period over which they charge MRP is commensurate with the period over which their capital expenditure provides benefits, including a realistic assessment of expected credit losses, we recommend that the council undertake regular reviews of their MRP to ensure that any additional expected credit loss has been factored in. |

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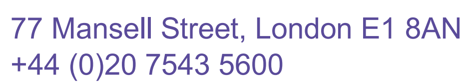


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