Resources and Fire & Rescue Overview and Scrutiny Committee

27 May 2021

Warwickshire Recovery & Investment Fund (WRIF)

Recommendations

That the Committee:

1. Considers the appropriateness and adequacy of the County Council's draft governance, control, monitoring and decision-making arrangements as set out in this report.

2. Makes recommendations to Cabinet in respect of any amendments to the proposed arrangements in the report and/or recommends revised or additional arrangements.

3. Considers and makes recommendations on the WRIF's draft inaugural Business Plan and WRIF Investment Strategy in advance of them being submitted to Cabinet for approval.

Report structure:

1. Introduction
2. The Economic Outlook for Warwickshire
3. WRIF Objectives, Investment Principles and Potential Benefits to Warwickshire
4. Executive Summary of the WRIF Proposal
5. WRIF Governance
6. Legal Considerations
7. Financial Considerations

Attachments:

Appendix 1: Draft WRIF Business Plan
Appendix 2: Draft WRIF Investment Strategy (for Cabinet)
Appendix 3: Revised WCC Investment Strategy (for Council via Cabinet)
Appendix 4: Revised WCC Treasury Management Strategy (for Council via Cabinet)
Appendix 5: Draft WRIF Prospectus
Appendix 6: WRIF Comms Plan

1. Introduction

1. A major component of the Council's Covid-19 Recovery Plan is the establishment of a Warwickshire Recovery & Investment Fund (WRIF) to support new and existing businesses, both within Warwickshire and those aiming to relocate to the county. This proposal utilises the Council's strong financial position to invest in carefully chosen opportunities that, if successful, would maintain and develop the local economy and attract additional private investment. This would be to further the Council's objectives including, but not limited to those on the economy, environment and social value.

2. The purpose of this report is to ask the Committee for its comments and recommendations on the draft WRIF business plan and supporting documentation, including the WRIF Investment Strategy, and the governance arrangements described within. The Committee is invited to note that Cabinet resolved the following when it first considered detailed WRIF proposals (WRIF Business Case) on 11 February 2021:

   That Cabinet:

   - Supports the Business Case to establish the Warwickshire Recovery and Investment Fund

   - Approves in principle the establishment of a Warwickshire Recovery and Investment Fund (WRIF) and authorises the Strategic Director for Resources to finalise the proposals and the fund allocations and to develop the Year 1 Business Plan based on the principles set out [in the February Cabinet report] for further consideration by Cabinet.

   - Supports the proposed WRIF governance arrangements and approves the establishment of a Member Oversight Group and an Officer Investment Panel as more fully described [in the February Cabinet report].

   - Notes that a further report will be brought back to Cabinet to approve the final arrangements, including the 2021-22 Business Plan and to ask Cabinet to consider making the recommendations to Council in respect of the changes considered necessary to the Treasury Management Strategy and the Investment Strategy and to add the WRIF loan facility to the capital programme

3. The material presented as appendices to this report to the Resources and Fire & Rescue Overview & Scrutiny Committee (OSC) includes the draft inaugural WRIF Business Plan and its associated documents mentioned in the final bullet point, above. Comments and recommendations from the OSC will be included in the report to June Cabinet which will accompany the draft WRIF Business Plan and inaugural WRIF Investment Strategy.

4. Recommendations relating to the following will be submitted to Cabinet on 17th June 2021 with the WRIF Business Plan and associated documents:

a) To approve the inaugural Business Plan for the WRIF
b) To approve the WRIF Investment Strategy
c) To approve WRIF Governance
d) To approve the WRIF performance framework
e) To approve funding arrangements for the WRIF
f) To note the amended WCC Treasury Management and WCC Investment Strategies, before submission to full Council on 1st July 2021 for approval

5. In addition to Cabinet approval of the WRIF Business Plan and WRIF Investment Strategy, Cabinet will be asked to consider amendments to the Council's Treasury Management and Investment Strategies. These final two will then need to be submitted to full Council for approval, along with a covering report and recommendations. There will also be a second report to Council to add the facility to finance the WRIF to the capital programme.

6. The Committee is invited to note that the Council has received independent legal advice on the setup of the WRIF and the initial advice on setup was summarised in the 11th February 2021 Cabinet report covering the WRIF Business Case. The advice covered matters such as compliance with the Council's fiduciary duties and the new subsidy control regime. Subsequent advice has covered matters relating to anti-money laundering. This advice is available to members separately but is summarised in section 6 of this report.

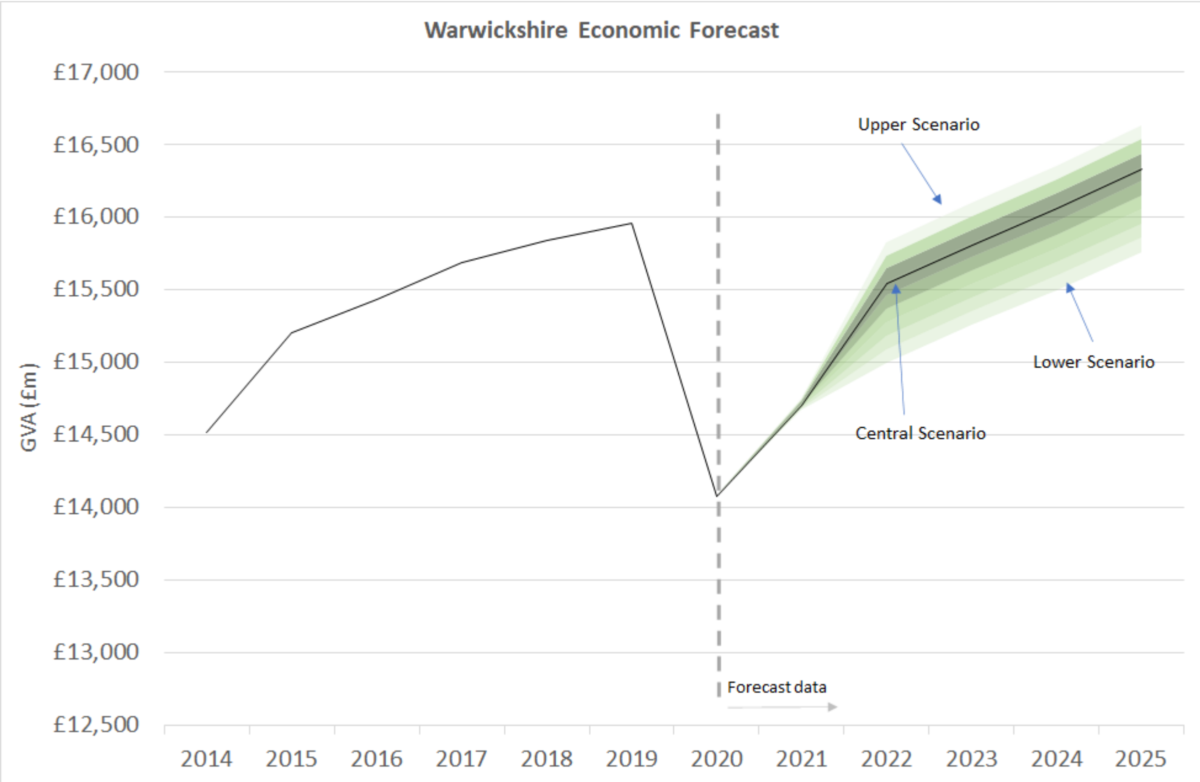
2. The Economic Outlook for Warwickshire

7. As mentioned, the WRIF is a key component of the Council's Covid-19 Recovery Plan. Priority 7 of the Plan is "Invest in regeneration and a sustainable future", which includes as an action, "[to] develop a proposal for a Warwickshire Recovery Investment Fund and progress other capital investment to support the recovery of our local economy".

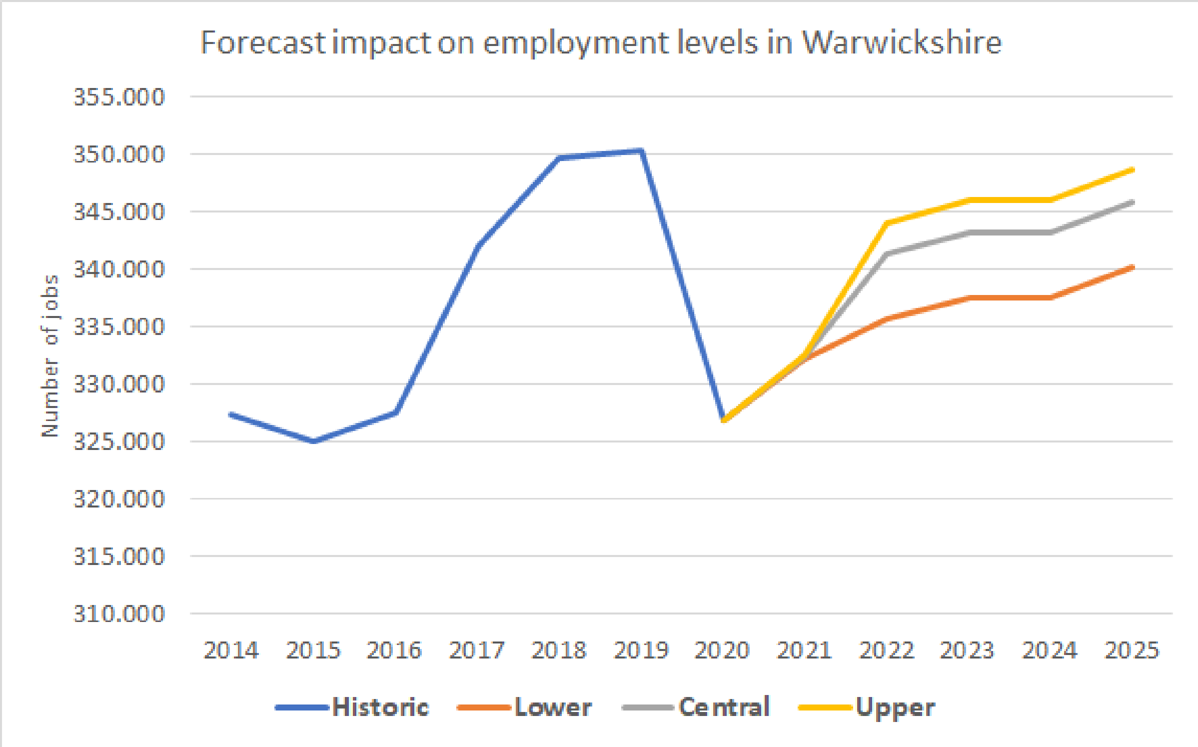
8. The economic case for the WRIF was initially developed by SQW last year, and the forecasting was updated for the February Cabinet report in light of the likely impacts of the second national lockdown. The Council's Economy & Skills team have since reassessed the modelling again, in light of the extension of the various Government support schemes (particularly job furloughing, business rates and tax holidays), and the successful movement along the roadmap out of lockdown and the rollout of vaccinations. Furthermore, we have seen that the second lockdown has not had such a negative impact on the economy as the first, as businesses, employees and consumers have learned to adapt to different ways of working.

9. There is inevitably a significant level of uncertainty around this forecasting work, and a range of potential scenarios that need to be considered. There has been a considerable uptick in business confidence, and the early signs as restrictions are eased are showing strong levels of consumer demand and spending which suggests a potentially relatively quick recovery. However, there remain concerns as to the sustainability of current consumer behaviours, and that as and when Government support measures are withdrawn, businesses will face considerable pressures around cashflow due to limited reserves and lack of both investment and working capital.

10. There is consequently a risk of a further wave of business closures and redundancies towards the end of 2021. As a result, the Council's Economy & Skills Team have reviewed the various different national economic forecasts, likely trajectories for different sectors of the economy, and applied them to Warwickshire's economy. Looking at both the optimistic, higher end scenarios and more pessimistic lower end ones, the team has produced the following fan chart.

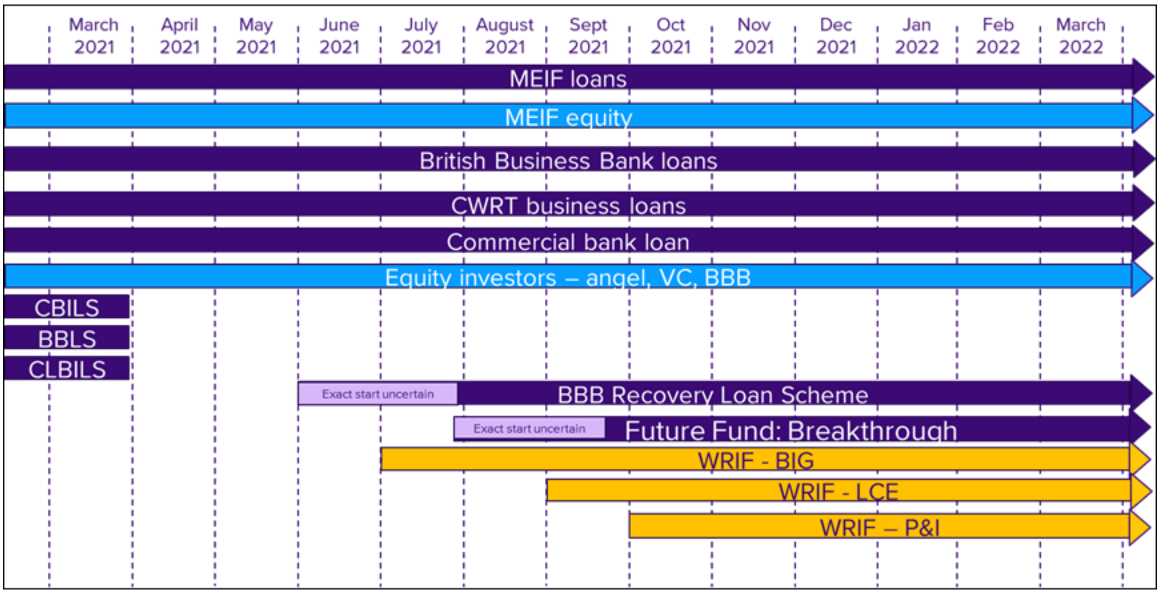


11. In terms of employment levels within the county, the following graph presents modelled forecasts for the numbers of jobs within the county. The Committee is invited to note that although the upper and central forecasts for economic output see a relatively quick return to pre-pandemic levels, employment is forecast to return much more slowly, and in all scenarios does not return to pre-pandemic levels during the forecast period.



12. While the revised forecasts suggest an improved picture and a faster recovery than initially thought, this is clearly not guaranteed, and it is vital that Warwickshire seeks to maximise the opportunities for recovery and future investment that could otherwise occur elsewhere.

13. Economic support programmes delivered by and for central government are included on the following timeline in the draft Business Plan. This demonstrates the timeliness of the introduction of the respective WRIF pillars shortly after the phasing out of the Business Intervention Loan schemes.



Acronyms	
MEIF	Midlands Engine Investment Fund
CWRT	Coventry & Warwickshire Reinvestment

	Trust
VC	Venture Capital
BBB	British Business Bank
CBILS	Coronavirus Business Interruption Loan Scheme
BBLS	Bounce Back Loan Scheme
CLBILS	Coronavirus Large Business Interruption Loan Scheme
WRIF – BIG	Warwickshire Recovery & Investment Fund – Business Investment Growth pillar to 2025/26
WRIF – LCE	WRIF Local Communities & Enterprise pillar to 2025/26
WRIF – P&I	WRIF Property & Infrastructure pillar to 2025/26

14. In summary, the implementation of the WRIF aligns with the Council's objective to promote economic recovery, the economic outlook remains challenging and the introduction of the WRIF coincides with the phasing out of central government support, including the various Business Intervention Loan Schemes.

3. WRIF Objectives, Investment Principles and Potential Benefits to Warwickshire

15. The Business Plan reiterates the objectives, principles and expected benefits of the WRIF. It describes the current state of the fund market and gives suggested targets for the WRIF, in accordance with the objectives of it.

16. The objectives for the WRIF are to:

- Provide access to finance that helps businesses in Warwickshire start, grow and scale up; or helps businesses locate to the county;
- Leverage additional resources or funding for the county through the investment and support of key growth businesses;
- Secure an ongoing financial return, commensurate with risk;
- Make investments that deliver benefits and social value to the residents and communities of Warwickshire in both in the short term (0-12 months) and medium term (1-5 years);
- Fill a gap in access to finance for businesses in Warwickshire;
- Support investments that make a contribution towards meeting net zero carbon goals; and
- Support the delivery of the Council's strategic goals and policy objectives as set out in the Warwickshire Council Plan 2025, COVID 19 Recovery Plan, Economic Strategy, Commercial Strategy and Place Shaping Programme.

17. The main principles of how the WRIF should operate are to:

- Support businesses either based within Warwickshire or looking to locate to the county;
- Create a diversified and balanced portfolio of risk-based investments that protect the public purse, support business and both creates new and protects existing jobs;
- Manage risk and target full recovery of investments;
- Generating permitted financial returns;
- Provide a flexible tool to consider and enable a range of opportunities for supporting business;
- Support business through investments based on agreed investment criteria and priorities that are developed from analysis of the economy and strategic sectors and support key sectors and growth, rather than weaker sectors;
- Support investment opportunities that will deliver against clear criteria that align with WCC outcomes and priority objectives - this is done not to deliver commercial returns/yield but to deliver Council objectives by filling a gap in the market;
- Target priorities by promoting investment in priority sectors, business types and investments that enable development, and provide wider social value benefits across the Warwickshire economy;
- Create an investment profile that grows slowly to avoid excessive risk with clear management and monitoring pathways to avoid creating a cost to the revenue budget/tax payer;
- A consistent and streamlined approach to considering investment opportunities and ensure all investment decisions are made against agreed investment criteria and align with Council priorities and outcomes;
- To amplify and complement the existing investment landscape and other recovery packages; and
- Provide funding within the limits and requirements set out in the council's non-treasury Investment Strategy.

Proposed Benefits

18. It is intended that the WRIF will give a particular focus to investment opportunities that:

- Stimulate job creation of skilled or entry level jobs in the county;
- Can or will leverage additional resources or funding;
- Help meet the net zero carbon targets for the Council and County; and
- Increase social value – where the investment brings benefits to local residents, removes barriers to employment, supports health and well-being, protects and enhances the natural environment, creates better places to live and/or maximises opportunities to strengthen community capacity and resilience.

19. Modelled benefits of WRIF include the following:

Support business and grow the economy; create the conditions for business innovation and investment to support business growth in growing sectors and drive economic growth.	Annual GVA / Value of GVA uplift to the County Number of new start-up businesses / businesses supported Business rates income Council tax income County-wide equitable distribution of funding
Increase the rate of employment; investment stimulates job creation with an increase of skilled or entry level jobs in the County	Number of jobs created/ filled by unemployed Number of jobs safeguarded
Provides employment land and premises; investment addresses the lack of appropriate employment land and premises in the County	Creation of employment land and premises – commercial space completed then occupied Amount of land developed/enabled
Enables Carbon reduction; investment in environmentally and/or economically sustainable businesses that are driving climate change benefits, carbon neutral and low carbon initiatives	An increase in the use of/public support for low and zero carbon technologies Number of responsible investments
Increases Social Value; investment brings benefits to local residents by promoting initiatives that increase skills and capabilities, removes barriers to employment, improves health and wellbeing, protects and enhances the natural environment, creates better places to live and maximises opportunities to strengthen community capacity and resilience.	Poverty premium - how many people’s lives have they touched and households helped

WRIF at £140m

Projected outcomes	**Summary**
Jobs created	2,500 - 3,400
Jobs safeguarded	2,700 - 3,900
Annual regional GVA (£m)	110 - 160
Number of Businesses supported	118
Private sector leverage (£m)	78 - 104
Public sector leverage (£m)	26 - 35
Land & development enabled (hectares)	15-23

Business plan targets (2021/22)

- Amount invested: £22m
- Companies supported: 12
- Value of leverage: 0
- GVA uplift: 0
- Jobs created: 0

- Jobs safeguarded: 390
- Amount of land/development enabled: 0

4. Executive Summary of the WRIF Proposal

20. The following table contains key points about the WRIF and is drawn from the relevant parts of the draft Business Plan, WRIF Investment Strategy and other associated documents. The purpose of it is to provide the Committee with an ‘at a glance’ overview of the key points about the WRIF that are being submitted to Cabinet for decision on 17th June. Although the key points are captured in this table, the remainder of this report goes into further detail.

Quantum	<£140m over the five years MTFS period, with funding split across three investment pillars. £130m will fund capital investments that will be funded from a mixture of external and internal borrowing, and £10m will fund revenue investments that can only be funded from internal borrowing.
Potential benefits	Unlock and secure new and additional private sector investment (c. £98m) Create new jobs in the county (c. 2,500+) Generates a figure of £4.6m NPV
Lifecycle / duration	WRIF is a ‘closed fund’, time limited for 5 years, after which there will be no further investments made unless it is decided by the Council that the WRIF remains aligned to the delivery of the Council Plan, there is demand for it to continue and it continues to be affordable for the Council. Funding provided to applicants will occur in the first 5 years, with repayment profiles lasting up to 10 years from the date of the loan being made.
Governance	Cabinet agreed the governance arrangements on 11th February. So after Cabinet considers the Business Plan the next step would be to establish the Investment Panel, chaired by the Strategic Director for Communities; this makes recommendations on investments (for Business Investment Growth and Property & Infrastructure pillars) to Cabinet. Also, the cross-party Member Oversight Group chaired by the Portfolio Holder for Finance will be established and there will be ongoing involvement by Overview & Scrutiny and Audit & Standards Committee. The Member Oversight Group will also play a role in the Warwickshire Property & Development Group (WPDG) governance.
Pillar key features	**Business Investment Growth** (£90m over 5 years): • Focus on providing finance for growing businesses in Warwickshire with sound prospects in sectors where Warwickshire has particular strengths • <£10m per investment, numbering indicatively. 2-5 per annum. **Local Communities & Enterprise** (£10m over 5 years): • Focus on meeting local, smaller scale requirements for access to finance with the aim of maintaining social capital in communities, supporting new local small businesses and creating entry level jobs in priority sectors • <£500k per investment, numbering indicatively. 10-30 or greater per annum (average loan modelled is £100k) **Property & Infrastructure** (£40m over 5 years):

	• To enable development in the County, facilitating new employment, land and commercial premises and which could also include investing in commercial sites and premises • Up to £40m investment, to a maximum 10 year term
Pillar management	**Business Investment Growth** to be managed internally. Investment recommendations are made to Cabinet by an Investment Panel chaired by the Strategic Director for Communities. **Local Communities & Enterprise pillar and Property & Infrastructure pillar** LCE to be managed by external fund manager/s and PIF expected to have an element of external fund management, subject to final arrangements being determined. Where a fund is externally managed, the Council will set investment parameters (the criteria, limits and requirements from the WRIF Investment Strategy) through the procurement process and those could be enshrined in the contract between the Council and the external fund managers. However, in the case of the LCE pillar, day to day investment decisions would be made by the external fund manager in line with the framework and criteria laid down by the Council. PIF investment decisions are expected to follow the same process as the BIG pillar in terms of final decision making.
WRIF targets (2021/22)	Amount invested:£22m Companies supported: 12 Value of leverage: 0 GVA uplift: 0 Jobs created: 0 Jobs safeguarded: 390 Amount of land/development enabled: 0
Dependencies	Facilitation of the investments by the Investment and Treasury Management Strategies Funding allocation to WRIF Appointment of external fund manager/s Resourcing in place
Risks	Risk is summarised immediately below this table

Risk

21. The Council has adopted as part of its Strategic Risk Management Framework a set of descriptors of risk tolerance, these include:

- Averse - Avoidance of risk and uncertainty is a key organisational objective;
- Minimalist - Only prepared to accept the possibility of very limited adverse impacts in all circumstances;
- Cautious - Tolerance for risk taking is limited to those events where there is little chance of any significant downside impact;
- Open - Tolerance for decisions with potential for significant risk, but with appropriate steps to minimise any exposure and deliver benefits; and
- Hungry - Eager to pursue options offering potentially higher rewards despite greater inherent risk.

22. The WRIF Business Plan describes the Council's risk appetite (which may be reviewed and changed over time) in terms of WRIF as 'Open':
'The risk of financial loss from commercial decisions, but where risk is managed to enable participation in new opportunities with significant gains'

23. Whilst there are potentially benefits that can be delivered in the County by the WRIF, there are also risks associated with it. These and mitigating actions that can be taken to address them have been summarised in the table below for the Committee.

Risk	Potential Management & Mitigations
Governance Insufficient resource and expertise is committed to the business case process that supports any investment decision and as such investment decisions are poor and increase the likelihood of loss. The Council is slow in making corrective actions where investments are performing below expectations Recent coverage of Local Authorities getting into difficultly when making loans to third party entities has highlighted the need for a robust understanding of the risks, governance arrangements and the need to quickly identify and act on any financial issues. Appropriate training, sufficient understanding of investment and purpose, timing of returns and robust reporting against issues where all identified as key areas to Council wishing to undertake these activities.	 The Council must identify sufficiently qualified resource to ensure business cases are robust and any investment decisions properly understood. Reporting should be sufficiently regular and detailed to ensure that issues are identified and addressed in a timely manner. The Council should pay regard to recent Public Interest reports in this area and ensure that lessons learned are embedded in the governance of the WRIF. A key element highlighted in the reports was the need to challenge optimism bias and for appropriate training and skills for officers and also training for members to enable members to adequately scrutinise and challenge the information they receive.
Finance and Funding Risks[1] Interest rates are currently at historically low levels, with some commentators believing that the current market outlook may push these rates lower. As such, debt is currently relatively cheap, although this could be considered the new norm when looking at the current Government Bond Market. There is a risk that the future success of the	 The Council has a corporate Treasury Management strategy that allows rises in interest rates to be managed across a range of financial instruments thereby lower the impact of future rate increases.

[1] Financial risks are covered more extensively in paragraph 94 of this report

Risk	Potential Management & Mitigations
programme could be impacted by an interest rate rise. Subsidy Control regulations - Investment decision making will need to be carefully monitored to ensure compliance with changing subsidy control regulations	Regular monitoring of compliance with subsidy control regime as part of due diligence and specific investment business case prior to investment decision making
Debt monitoring and recovery Where an element of a fund is internally managed there is insufficient resource applied to monitor and recover debts once the initial investment has been made.	Sufficient resource must be identified to monitor and report on the performance of the funds. Market Testing has indicated the total costs of the Fund to be in the region of 2% of the total sums invested, which is in line with industry norms.
Default levels exceed Fund estimates Default rates have been estimated based on the financial strength of the counterparties. However, as the Fund is focused on Growth and Recovery losses may exceed those expected and there may be insufficient set aside to cover Fund losses.	The creation of the commercial risk reserve (£7.5m) as part of the 2021/22 MTFS provides additional financial cover in the short term should the level of loan repayment defaults be higher than those expected in the business plan until such time as corrective action to the operational arrangements for the WRIF or the next MTFS refresh can be put in place. The value of the reserve will be assessed each year for prudence and adjustments made accordingly. Where losses exceed expectations, this should be fed back to the Investment Panel and consideration given to a tightening of investment criteria.
Investment Objectives Investment objectives are unclear, not consistently applied or don’t adapt to meet changing market conditions or the needs of the Council.	Regular review of the relevance of the investment objectives, including their rationale, is vital in keeping the programme and

Risk	Potential Management & Mitigations
	investment decision making responsive. The investment strategy, against which bids are assessed will be reviewed and reapproved on an annual basis.
Local Government Regulation There is currently heightened scrutiny in the Sector, where authorities are looking to support their financial positions through the use of commercial investments. This increases the risk of changes to Local Government Regulation that may inhibit the ability of the Council to invest in such activities or increase the cost of doing so. Failing to meet the current PWLB rules would have an adverse impact on the Council's ability to borrow for future activities. For instance, regulation around MRP has been adapted to respond to current market activity and borrowing requirements from PWLB have recently changed.	The Council has identified key individuals responsible for the regular review of all legislation and financial requirements. The Council must have the flexibility to alter investments if those changes would adversely impact the ability to borrow/fund statutory services. The WRIF proposals are policy-driven investments and therefore comply with the current regulatory framework.

Market Engagement on the WRIF Proposals

24. Market engagement was undertaken as part of the development of the WRIF proposals. The findings of this exercise indicated support from those consulted for the main aims and objectives of the WRIF and recognition that the different pillars were appropriately aligned to address a number of gaps in the current investment market. The following feedback arose from the market engagement and proposals within the Business Plan have been adapted accordingly:

- There is an ongoing demand for finance, particularly from those businesses that have not accessed existing government support;
- The overall fund and its pillars would benefit from clearer definition of purpose and focus;
- It would be useful to split more clearly into debt and equity offerings, in recognition of the fact that fund management services are different between the two;
- Outcomes relating to each pillar would benefit from a clearer focus, noting that a broader range of measures require more input/cost from a fund management perspective;
- Minimum fund size for external fund management indicates that any equity investment element should be considered for in-house management given the

proposed scale of finance available;
- Limited appetite for finance from social enterprises;
- However, there was an indication that supporting business/investor readiness for these business types in the short term would enable investment and growth in the medium term;
- There remains a gap in finance availability for debt <£500k and £1m-£5m; and
- The next 18 months is a key time for making finance available; as national government schemes stop, the WRIF can help avoid a ‘cliff edge’ in availability of finance for businesses.

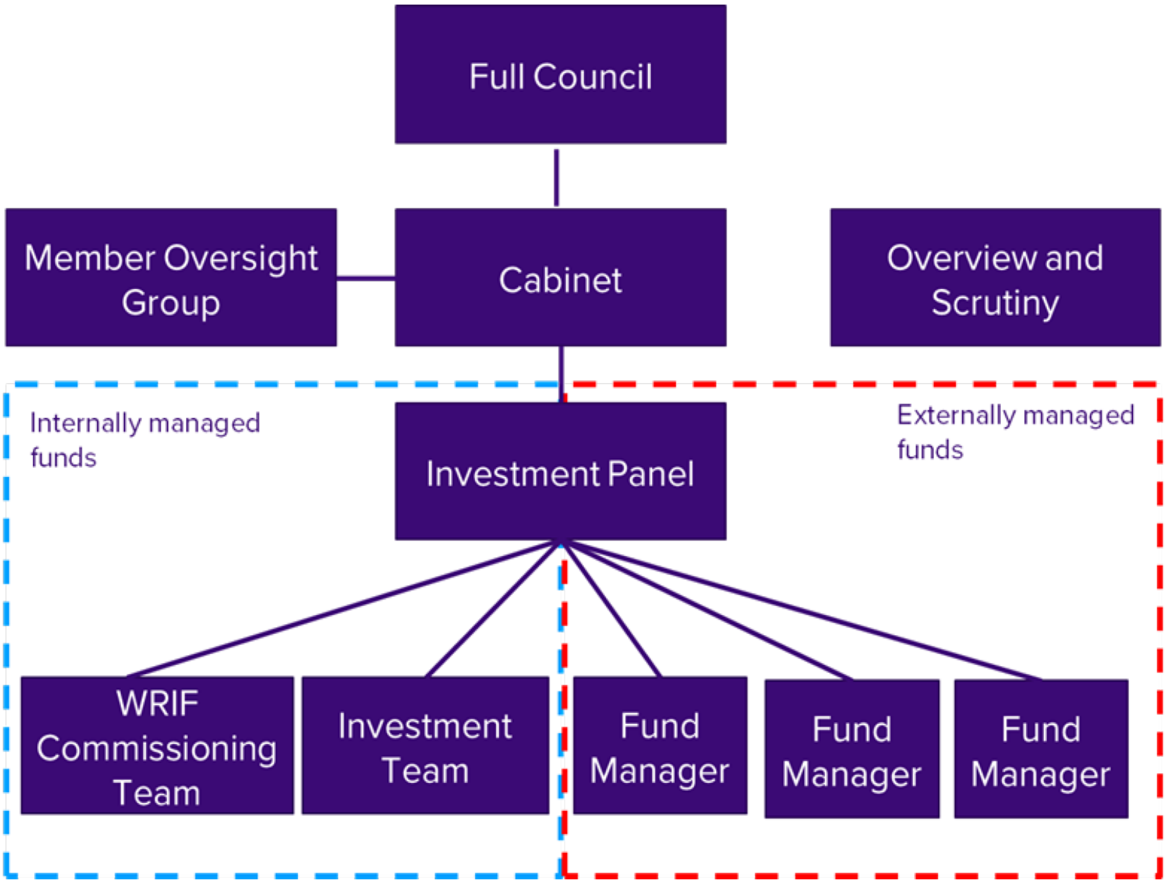
5. WRIF Governance

25. In section 2 of the Business Plan, WRIF delivery is described in terms of a ‘mixed economy’ in which the Council internally manages some aspects of the fund, with the support of external advisors, and outsources other parts of the fund to be managed by an external Fund Manager(s) or providers:

    - Business Investment Growth pillar will be managed in-house by the Council with support from external advisors.
    - Local Communities & Enterprise pillar will be managed by an external Fund Manager(s).
    - Property & Infrastructure pillar is expected to have an element of external fund management, subject to final arrangements being determined.

26. The external Fund Managers will operate within their brief (as determined by the WRIF Investment Strategy) and, in the case of the Local Communities & Enterprise pillar, will make investment decisions independently of the Council’s decision-making bodies (WRIF Investment Panel and Cabinet). In contrast, proposed investments within the internally managed Business Investment Growth and Property & Infrastructure pillars will go to the WRIF Investment Panel for consideration and a subsequent recommendation to Cabinet, which will make the final decision on investments. Beyond proposing updates to the WRIF Investment Strategy to Cabinet and setting external Fund Manager priorities, the role of the WRIF Investment Panel is to develop the overall performance framework and undertake contract management of external Fund Managers.

27. The proposed governance arrangement is illustrated in the following diagram from the Business Plan:



28. The membership of the Investment Panel is proposed as:
    - Strategic Director for Communities (Chair)
    - Strategic Director for Resources (optional)
    - Business & Economy & Growth/Regeneration representation - Assistant Director: Communities / Strategy & Commissioning Manager: Economy & Skills
    - Governance & Policy representation - Assistant Director: Governance & Policy / Strategy & Commissioning Manager: Legal and Democratic
    - Strategy and Commissioning Manager (Property Management)
    - Finance representation - Assistant Director: Finance (Deputy S151) / Strategy & Commissioning Manager: Strategic Finance / Strategy & Commissioning Manager: Treasury, Pension, Audit & Risk
    - External Advisors (to be determined)

29. The Member Oversight Group (MOG) will be dual-purpose, with a remit covering both the Warwickshire Property & Development Group (WPDG) and the WRIF. Terms of reference for the MOG are in draft. The role of all or the relevant bodies within the Council, including those already established, is summarised in the table below:

Group	Role
Full Council	Approval of MTFS, budget, Treasury Management Strategy and Investment Strategy

Group	Role
Cabinet	To approve the annual Business Plan To review previous year's performance To recommend the WRIF budget for subsequent years To agree priorities for external fund managers, provided they are consistent with the Council's Investment Strategy To approve and agree amendments to the WRIF Investment Strategy To approve individual investments (within the BIG and PIF pillars) in line with WRIF Investment Strategy. N.B. individual investments for the LCEF pillar by external fund manager/s will not be approved by Cabinet
Council	To approve WRIF funding To approve the Council's overarching Investment Strategy and Treasury Management Strategy and their controls and protocols that the WRIF must operate within
Overview & Scrutiny Committee	To have oversight and to scrutinise the WRIF arrangements and its performance as determined by the relevant Overview and Scrutiny Committee through the setting of its work programme
Audit & Standards Committee	Ensuring that the Council has robust systems of internal control and making sure that both councillors and officers follow high standards of conduct in the way they conduct the business of the Council
Member Oversight Group	To consider and provide representations on the direction, scope and priorities of the WRIF Investment Strategy To have oversight of the fund's performance on policy and financial grounds, assessing delivery of the annual business plan To develop a greater understanding and build expertise and skills in the analysis of the investment market and investment opportunities
Investment Panel	To recommend the approval of the annual Business Plan to Cabinet To agree proposed updates to the WRIF Investment Strategy and priorities for external Fund Managers and make recommendations to Cabinet To approve which opportunities are to proceed to Investment Business Case stage, following the sift process To make recommendations to Cabinet on individual investments within the BIG and PIF Pillars (individual investments by the external fund manager for the LCE Pillar are not received by Cabinet) following Business Case completion To monitor performance of individual investments and portfolio

Group	Role
	and take corrective action where necessary To monitor progress and performance and take action as necessary, of the WRIF portfolio in terms of performance against targets, balance, diversification and risk exposure To monitor benefits realisation
WRIF Commissioning Team (within Economy & Skills)	To provide subject matter input into the regular review of the WRIF Investment Strategy and ensure it reflects the needs of local businesses, the local economy and the investment market To provide input into the annual Business Plan To develop overall performance framework and undertake contract management of external Fund Managers To source investment opportunities To provide the 'front door' first point of contact for applicants to the WRIF To promote and signpost potential applicants To work with businesses in advance of submitting funding/investment requests To provide and coordinate business support programmes To sift and evaluate opportunities in line with the Investment Strategy To prepare Investment Business Cases for Investment Panel consideration Manage the pool of external advisors called off via a new dynamic purchasing system (DPS) for business support services as required To write reports to the Member Oversight Group on pipeline of investment approvals and those rejected or referred for further support.
WRIF Investment Team (within Finance)	To lead and coordinate the preparation of the annual Business Plan for Investment Panel approval To lead and coordinate preparation of the annual refresh of the Investment Strategy To establish the Investment Panel and have an ongoing role in monitoring governance arrangements to ensure they remain robust To lead on and coordinate the due diligence process to inform individual investment business cases To support the Investment Panel in evaluating opportunities, by undertaking due diligence and providing a report on the overall investment portfolio To monitor progress and performance of investments and portfolio, including on risk (for internally managed investments) To manage the financing of investments (e.g. via internal and external borrowing)

Group	Role
	To oversee and manage accounting requirements Manage the pool of external advisors as required Maintain the WRIF Risk Register and own responsibility for relevant mitigating actions
External Fund Managers	To source investment opportunities To sift and evaluate opportunities in line with the Investment Strategy and contract, including undertaking due diligence To make investments To monitor and regularly report on progress and performance of investments and portfolio To provide open access to information and performance data to WCC

6. Legal Considerations

30. The Council has sought external legal advice in developing the WRIF proposals. This covers Council's powers to set up the fund, relevant considerations prior to investing or offering products through the fund (including the Council's fiduciary duties in respect of public money and appropriate governance), changes to state aid rules post EU transition, and regulatory requirements. The full legal advice is available to members on a confidential basis if required.

Legal Powers (vires)

31. The external advice confirms that the Council has the necessary legal powers to establish the WRIF. These are derived from:

- The General Power of Competence (for lending, funding and other activities);
- Section 12 Local Government Act 2003 (power to invest);
- Local Authorities Land Act 1963 – acquiring, developing land and funding for certain third party developments;
- Section 120 Local Government Act 1972 (acquiring land – particularly for the benefit, improvement or development of its area); and
- The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 – (treatment of receipts and capital treatment of certain loans).

32. The legal powers will need to be subject to ongoing review over time depending on the size and scale of the WRIF's activities to ensure that governance arrangements are robust, fiduciary duties are considered and that there is compliance with the requirements of any Public Works Loan Board (PWLB) borrowing.

Fiduciary Duties

33. In making decisions about the establishment of the WRIF and approving the funds, the Council must have regard to its fiduciary duties. These can be summarised as the

Council acting as trustee over the tax and public sector income (and liabilities) on behalf of its local taxpayers and other residents. The Council in effect holds money but does not own it; rather, it spends money (and incurs liabilities) on behalf of its business rate and council taxpayers.

34. Due to the size of the proposed investments going via the WRIF together with the risk of losses which attach to any investment and the fact that the Council will be funding something different from typical local authority activities, has resulted in careful consideration being given to the Council's fiduciary duties in relation to this project. A summary of this position is set out below:

Considerations	**How addressed**
Clarity of the policy objectives/outcomes which WRIF (or its separate streams) are designed to support/deliver	Section 3 of this report covers the policy objectives / outcomes which the WRIF is designed to deliver. The evidence base for the need for these objectives is contained in the SQW report (August 2020) and the updated economic analysis set out in Section 2 of this report
Options Appraisal – assessment of WRIF versus alternative routes to deliver the policy/objectives. Why are the WRIF proposals best suited to deliver these?	The options appraisal is set out at paragraph 142 of the WRIF Business Case (received by the meeting of Cabinet on 11/2/21) and concludes that WRIF is the most appropriate policy option for the Council to pursue
Financial impact (to the Council) of the proposals and the risks of non-recovery and steps to mitigate/manage such risks. If some of funding is expected to be non-recoverable, this should be identified.	This is set out in detail in Section 6 of the WRIF Business Case (received by the meeting of Cabinet on 11/2/21) and covered at Section 7 of this report. The analysis includes the risks of non-recovery
Benefit of WRIF to target groups (who would benefit under WRIF) fairly balanced against the interests of Warwickshire's taxpayers/residents – i.e. the impact of the money being spent on WRIF (especially if a loss is projected or high level of risk is involved) on the Council's other activities/level of Council Tax.	The direct economic benefits of WRIF are estimated in paragraphs 214 and 215 of the WRIF Business Case (received by the meeting of Cabinet on 11/2/21). These show an annual contribution to the county's gross value-added of £110m – 160m
Fiduciary Duty considerations are not a one-off exercise. They remain relevant throughout the life of the programme. Members and officers need to continue to consider the above points – i.e. act in an efficient 'business like' manner	This will be kept under review throughout the duration of the fund and any future Fund decisions taken

35. The Business Case projects that the Local Communities & Enterprise (LCE) pillar will potentially make a loss given the profile of investments and the industries supported. However, the fact that not all funds, i.e. the LCE pillar within WRIF, are projected to be recovered in full does not, in itself, mean that the Council is failing in its fiduciary duties if it supports the WRIF. It does mean that the Council needs to recognise that there is a potential risk, in particular in relation to LCE pillar, and decision makers need to properly consider the following issues before reaching their decisions:
    - the quantum of loss;
    - whether there were alternative ways to deliver the policy objective considered and whether these involved less risk of loss;
    - whether other aspects of the WRIF programme compensate for the forecast shortfall;
    - whether the proposals are better than a grant (100% loss); and
    - how would the projected loss impact on the wider interests of the Council's taxpayers/residents.

36. As set out in the table above, these fiduciary duties will be relevant to future decisions in relation to the activities of the Fund including:
    - allocation of further Council funding to the WRIF;
    - scoping and approving new products / initiatives;
    - approving individual transactions; and
    - active management and monitoring of the WRIF pillars' performance. These aspects will need to be kept under continual review throughout the Fund's existence and will need to be covered in any future reports to Members.

Subsidy Control, Regulatory Requirements and Governance

37. Prior to Central Government outlining its response to the recent consultation on subsidy control (State Aid's replacement), the position is that broadly speaking the same considerations apply post-Brexit as they did before. The new subsidy control principles are broad and are focused on permitted subsidies being policy-driven, proportionate, necessary, and designed to incentivise policy-conducive economic behaviour. Given that the proposals for WRIF primarily involve the offer of loans at market rates, it is not considered that subsidy control will have a significant impact on the proposals, however this will be kept under review as the detail of the products available is developed and defined.

Anti-Money Laundering

38. Further external legal advice has been received, this time relating to Anti-Money Laundering (**AML**) and related considerations that the Council will need to address as part of the WRIF setup and operations.

39. In summary, whilst WCC is already subject to certain AML requirements, in particular in relation to ensuring that it does not directly or indirectly fund terrorism or deal with the proceeds of crime, the operations proposed under the WRIF, in particular the provision of loans to companies and LLPs and will lead to WCC being subject to further legal requirements.

40. Provision of loans and making of investments is an activity regulated by statute (a **Regulated Activity**). As a result of the Council performing Regulated Activities, and as a matter of good governance, the Council will need to:

i) ensure that the existing AML regime is fit for purpose, in particular:

a) that the Money Laundering Reporting Officer (**MLRO**) is aware of the WRIF and the wider scope of Council operations which may impact upon their role;

b) that the MLRO is aware of their obligations and how to deal with any concerns referred to them, including how to report any concerns to the National Crime Agency;

c) that the AML policy and procedures are reviewed and updated as necessary to reflect the wider scope of the Council's operations;

d) consider whether, in addition to the MLRO, a further compliance officer should be appointed, whether employees involved with the WRIF may need additional checks and whether a review of the AML regime should be scheduled at set intervals;

ii) ensure that suitable risk assessments are undertaken at the outset of each proposed transaction;

iii) ensure that customer due diligence is undertaken and recorded at the outset of each proposed transaction, and that the identity of the proposed customer is verified, together with the ultimate beneficial owner, and considered alongside the purpose and intended nature of the relationship;

iv) ensure that all Council staff with responsibilities in relation to the WRIF receive suitable AML training, including refresher training at suitable time intervals;

v) ensure that proper records of each proposed transaction are kept for at least 5 years; and

vi) depending on the final mix of loans and investments, the relevant security offered, the status of the borrower (i.e. limited company, LLP, sole trader/individual) and the choice of external fund manager, ensure that the correct registration is in place with the Financial Conduct Authority.

7. Financial Considerations

41. The financial nature of the WRIF is that it provides access to funding, on a repayable basis, to businesses in support of the Council's objective to support economic recovery and growth in Warwickshire post the pandemic. It should be noted that these financial implications have been prepared on the basis of the starting presumption that the WRIF should be financially sustainable. This gives rise to the following

financial questions that need to be considered if the decision to proceed with the WRIF and to operationalise the necessary arrangements is made:

- Does the WRIF meet the starting presumption that it will break even;
- Are the risks/sensitivities acceptable and are the rewards (both service and financial) commensurate with the risks;
- Does the Council have the financial capacity to provide the funding required not only when the decision to allocate funding is made but through to when the funding is due to be repaid;
- Does the Council have the skills, knowledge etc. to make the right decisions about the applications for funding made;
- If the level of default is greater than expected, is the Council able to manage the financial implications and what is the potential impact on the delivery of the Council Plan and MTFS; and
- Is the Council able to consolidate the WRIF into its financial planning, monitoring, and accounting requirements and well as risk management to ensure robust decision-making and oversight?

WRIF Interest Rates

42. The Council has commissioned a piece of work from Arlingclose to provide a robust model for calculating interest rates chargeable for loans to companies under the WRIF. The model has regard to the need for the Council to charge normal commercial rates for a given level of investment risk. The model has regard to the risk free rate (UK gilt yield) as a starting point and adjusts for a number of relevant risk factors including but not limited to the following:

    - the duration of a loan;
    - whether there is any security backing a loan;
    - whether a loan is fixed or variable rate;
    - the size of the company and the size of the loan;
    - key measures of the financial and commercial standing of the company;
    - the nature of the repayments, for example maturity or equal instalments; and
    - whether the company can provide actual track-record figures or has to rely on projections.

43. The model will report the expected default rate for a loan to assist the Council in assessing risk and ensuring that the loan rate is commensurate with risk.

Financial Impact of WRIF

44. Overall, the Business Plan demonstrates that, with a notional £140m investment in the WRIF and on the base assumptions, the WRIF would generate a net return of £4.6m. This equates to a net return on investment of 3.3%.

45. This gain is the aggregate of a net return on the BIG of £3.1m, on the P&IF of £2.7m offset by a net loss on the LCE of £1.2m However, the estimated losses with the LCE need to be considered in conjunction with the potential indirect benefits generated by supporting small business and the associated jobs.

46. The net financial return from the potential £140m investment makes it critical that the operational requirements within which the WRIF operates are set at levels which support a positive financial outcome and minimise the risk to the Council's investment, whether this be through investment returns, the level of default risk the Council is prepared to accept or the level of security over loans required. These requirements have been a focus of attention in the development of the business plan, the drafting of the WRIF Investment Strategy and in the development of the operational arrangements for the WRIF.

47. Once these criteria have been set, applications will need to be assessed against them by the Investment Panel as part of recommending which investments are taken forward. If applying the criteria results in insufficient applications coming forward to take up all the WRIF financial capacity this should not be mean the criteria should be relaxed without the potential financial implications for the Authority being taken fully reviewed.

48. Given the modelled levels of return, to ensure the Council meets its fiduciary duty to taxpayers, the outcomes in terms of the service and wider economic benefits to the residents of Warwickshire from the WRIF and individual investments should demonstrably outweigh the potential financial risks at both Fund and individual project level. The spreading of investment over 5 years provides the opportunity to assess risk experience and adjust investment amounts or investment protocols in later years. Financial monitoring and taking appropriate action in the light of experience will be a critical feature of risk management.

49. Sensitivity analysis demonstrates a strong likelihood of a positive return across the total WRIF, but demonstrates that the Local Communities & Enterprise pillar, taken in isolation, provides only a low chance of a positive return (Net Present Value or NPV), as per the below table from the Financial Case.

	Business Investment Growth	Local Communities & Enterprise	Property & Infrastructure
% Chance of Positive NPV	High	Low	High

50. For the Local Communities & Enterprise pillar to break even, there would have to be significant adjustments made to assumed rates of investment return, loan default rate and recovery on default. Therefore a cross subsidy model between the funds will need to operate, in order to support the viability of the Local Communities & Enterprise pillar. It should also be noted that although the probability of a positive return is high for the BGF and PIF, with any investment of this nature there is a risk of loss that cannot be completely eliminated.

51. In isolation, the Local Communities & Enterprise pillar has a low likelihood of a positive NPV, but it has a potentially vital role in delivering positive policy outcomes across the county, including job creation, increasing skills, supporting new businesses and maintenance of some of the County's environment and key social capital assets.

52. Using external expertise to manage the Local Communities & Enterprise pillar will assist in mitigating the risks associated with it. In procuring the expertise we will look for appropriate targets and incentives to form part of the contractual arrangements. In summary, these risks arise from the nature of the target market of the pillar and the types of product it is likely to offer.

53. The overhead and administrative costs of running the WRIF will be recovered through the use of application fees and from the interest paid on any loans. As a result, there is a minimum level of activity that the WRIF will need to undertake to ensure it meets the financial objective of at least breaking even. If solely lending from the BIG fund, the minimum level of activity required to recover the overhead and administration costs of operating the Fund is loans of £77.0m (85% of the total BIG Fund). Any under recovery of the operating costs will be an additional cost that will need to be met from future MTFS allocations.

54. Given the nature of the Fund any returns over and above those repaying the original loans and funding the WRIF running costs will be available to support the ongoing priorities set out in the WRIF investment strategy or to invest in other Council priorities. The options and affordability will form part of the annual MTFS refresh, Treasury Management Strategy and Council Investment Strategy refreshes and then built into the WRIF Investment Strategy.

Financial capacity to support the WRIF

55. There are three potential sources of funding for the £140m investment in the WRIF. These are:

- Borrowing;
- Temporary use of our cash balances; and
- Reserves.

Each of the sources of funding brings different opportunities and constraints. Also, the various types of WRIF investment/activity are only applicable to some of the sources of funding. This section considers each of the potential sources of funding in turn and its applicability to the products the WRIF could offer.

Borrowing

56. Local authorities are legally only allowed to borrow to fund capital expenditure i.e. something that creates an asset of lasting value. It does not matter whether the resulting asset is owned by the County Council or the investee. The potential activities of the WRIF that are defined as capital expenditure are the provision of loan finance for the creation/development of a fixed asset and the purchase of shares/equity investment. The financial model underpinning the WRIF assumes that £130m of the £140m investment will meet the definition of capital expenditure. It is for this reason that a recommendation to Council to add a capital facility to the Capital Programme is needed to make the funding to deliver the WRIF available.

57. The recommendation, subject to Council's approval, will add the required financing to the Capital Programme, but the ability to draw down funding would be subject to separate decisions as set out in the governance arrangements for the WRIF. The Capital Programme facility will be

reviewed and/or updated via the Budget Resolution in February each year.

58. At the end of March 2021, the Council’s level of outstanding debt was £321m with a further £200m of financing forecast to be required over the period of the 2021-26 MTFS as the financing approved for the Council’s own Capital Programme (including the Capital Investment Fund) and the investment required to support the delivery of the WPDG business plan. As stated above, the WRIF business plan estimates up to £130m additional capital spend through the WRIF, with £10m to be funded from internal resources. This borrowing would be additional to our current plans.

59. Whilst £130m is the maximum gross exposure to external debt within the WRIF, repayment profiles will mean that peak debt is significantly below this level. The business plan estimates that the maximum peak debt will be £67m in 2025/26. The financial modelling behind the Business Plan has demonstrated a peak funding level of £70.6m over the 5-year investment cycle. The Monte Carlo simulation (a model used to predict the probability of different outcomes) in the financial model has also indicated a high probability that the WRIF will produce a net positive return. The Council is also able to manage risk based on the overall economic and market conditions at the time. If losses start to increase, then the Council has the ability to slow or stop future investments or adjust lending criteria/parameters and invest in more secure counter parties.

60. Any request from WRIF for loan/equity finance will need to be considered in the context of the wider County Council borrowing profile. Our total borrowing profile is driven by the sum of Capital Programme plus WPDG plus the WRIF. Any assessment of affordability and risk from a treasury management/investment perspective will need to consider all of these in the round. It also needs to be recognised that this wider context will change over time and therefore the assessment needs to be “live” at the point the decision is made. From an investment and financial risk perspective the requirement for a decision made on a case-by-case basis supports the active management of our risk exposure and allows decisions to be progressed/delayed as circumstances dictate. For the avoidance of doubt this means that it is possible that a good bid may be rejected if the overall financing position were to be pushed outside of acceptable limits as set out in the Council's Treasury Management Strategy and Investment Strategy.

61. Any borrowing the Council takes out and then provides onwards through the WRIF as a loan/purchase of equity will be taken out on the basis that the financial returns from the investment more than cover both the interest and principal repayments to the Council that arise from taking out the borrowing plus any costs of the WRIF administration and decision-making arrangements.

62. The use of borrowing to fund any WRIF activity means the Council will need to be able to justify to PWLB (and therefore HM Treasury) that the Council is taking out the borrowing primarily for service reasons rather than to generate a commercial return. The Investment Strategy approved by Council in February 2021 and the refresh to be brought to Council in July 2021 make it Council policy to ensure our investment activity does not fall foul of the PWLB lending criteria that could exclude the Council from using this source of borrowing for the entirety of our capital programme for three years. Although there are alternative sources of borrowing, being rejected by PWLB could have implications for the Council's perceived financial standing to other lenders which could, in turn, impact adversely on the lending rates the Council is offered.

63. As a local authority, the Council is required to make sure it acts prudently in setting aside resources to repay the principal of any loans taken out to fund capital expenditure, which is the nature of the loans/equity investment it would be providing through the WRIF. The recent public interest reports on local authority owned companies determined that not setting aside resources because of an assumption that income would be received to repay the loans before they were due was not a prudent approach. Therefore, the County Council will make provision for MRP (the provision for the repayment of principal) in its revenue budget. The repayment of loans made through the WRIF would need to be structured in such a way as to ensure sufficient levels of repayment to offset the costs of financing our PWLB loan/s and hence creating no additional call on the Council's revenue budget.

64. The creation of the commercial risk reserve (£7.5m) as part of the 2021/22 MTFS provides additional financial cover in the short term should the level of loan repayment defaults be higher than those expected in the business plan until such time as corrective action to the operational arrangements for the WRIF can be put in place or the next MTFS refresh.

Temporary use of our cash balances

65. The Council currently has a significant level of cash balances. However, these cash balances are not unencumbered. They represent income we have received/collected in advance of the spend planned for using the reserve taking place e.g. reserves and borrowing deferred as the result of slippage in the capital programme. We are able to ‘lend’ these cash resources through our Investment Strategy provided we are confident that the cash will be returned and is available by the time the future commitments to its use materialise. The challenge is to make efficient use of these cash balances whilst they are held and at the same time protecting the security of them so that they are available when they are needed for their original purpose.

66. Any revenue loans made through the WRIF would need to be financed from this source if there is not to be an immediate cost to the MTFS. The detailed operational arrangements of the WRIF will need to ensure timely repayment of any such loans.

67. The Investment Strategy seeks to manage the overall financial risk to the Authority through the use of our cash balances in this way. It sets an overall maximum limit for such loans that should ensure we do not reach the position of having insufficient available cash to meet our commitments. Current commitments against this limit include the working capital loans to Educaterers and WPDG and the Council’s contribution to the CBILs. There will be an ongoing need to monitor the net level of outstanding debt in its entirety to ensure these limits are not breached and our financial standing impaired. With each new financial year the Treasury Management Strategy and Investment Strategy are renewed and if significant corrective action is required the strategies can be changed.

Reserves

68. The report proposes the use of £240,000 from the Economic Growth and Place Shaping Fund to complete the set-up work on the WRIF, the procurement of the external fund manager/s and the framework for the range of external advisors that may be required to support the due diligence of individual applications. This would leave £7.322m remaining in this Fund to support further initiatives over the period of the MTFS.

69. The report further proposes using £305,000 from the Commercial Risk Reserve to meet the operational shortfall in the first two years of the WRIF's operation. Replenishing this will be the first call on any surplus as the WRIF moves back to a breakeven position.

70. Overall, there is capacity in reserves to fund the short term/set-up costs prior to the WRIF becoming operational and the running costs of the WRIF before they are recoverable from the loans made. However, given the size of the numbers involved, there is insufficient capacity in reserves to fund wider WRIF investments.

<u>Summary</u>

71. The majority of the planned activity of the WRIF will be capital spend for the Authority. The only source of funding available for this activity is to take out additional borrowing (either external or through the temporary use of our cash balances). There is capacity to do this within the draft Treasury Management and Investment Strategies that will go to Council in July. A further report to Council will add the capital spend facility to the Capital Programme once the detailed business plan is agreed. Given that the premise on which the WRIF is being developed is that it is self-financing approving the addition to the capital programme will not undermine the sustainability of the MTFS.

72. Any revenue loans made can be funded from the Authority's surplus cash balances, provided this is within the annual limits set within the Investment Strategy.

73. The appropriate source of finance for each investment will be considered during investment decision making, when the opportunity is being reviewed, by the Investment Panel prior to making investment recommendations to Cabinet (in respect of internally managed funds) and by the external fund manager in other cases. Financing availability will be assessed when applications are considered, therefore it may or may not be the case that a specific kind of financing is associated with a particular capital investment.

Financing the WRIF Running Costs

74. As a local authority we have access to loans at lower rates of interest than can be obtained by commercial enterprises from the wider financial

markets. However, we are prohibited from passing on these lower interest rates in the WRIF investments. Instead our loans will be at market rates that takes into account loan terms and conditions and security so as not to provide unfair competition or to distort financial markets. As part of the development of the WRIF external expert advice has been obtained to enable appropriate interest rates for the different types of investment to be determined that would ensure we remain compliant with competition requirements.

75. It is the interest rate differential between the rate at which we can borrow money and the market rate we will charge on the loans made that will fund the WRIF running costs.

Funding applications decision-making

76. Critical to the financial success of the WRIF is that the decision-making about which funding applications to support is able to identify those that will be deliver the expected benefits and be able to make their repayments in full and on time.

77. This is likely to require a range of skills from those engaged in the process including understanding the market in which the business is operating, determining whether the proposal in application business case is likely to be successful, assessing the underlying financial strength of the company and their ability to make the loan repayments and assessing the ability of the management/leadership of the business to deliver the benefits of the investment proposed.

78. Undertaking this work is outside the current capacity of the organisation and therefore the extra capacity will be needed. The relatively small number of loans being assessed and approved for the internally managed funds also suggests that the range of skilled advisors is likely to be most efficiently and effectively achieved through the use of call-off contracts.

79. The estimated annual running costs of the WRIF included in the financial model are £564,000 a year, with a part year effect in 2021/22. This is comprised of:

- £159,000 for additional internal capacity across Economy and Skills and Finance;

- £25,000 for additional legal costs;
- £210,000 for the externally commissioned fund managers;
- £160,000 for expert advice; and
- £10,000 for ongoing marketing, communications and engagement.

80. This would equate to £2.553m over the period of the MTFS and £2.833m over the life of the WRIF, or 2.02% of the WRIF if the full £140m facility was used. Overall, this is slightly higher than the 2% cost assumed when the business case was considered last year.

81. £0.5m of these costs are expected to be met through application/arrangement fees with the balance of £2.333m being funded through the interest on the loan repayments.

Management of the downside financial risks

82. The base scenarios in the business case indicate that the WRIF proposals can deliver benefits to Warwickshire, and achieve a positive revenue impact on the Council. The more detailed operational arrangements set out in this business plan indicate that this remains the case. As set out above, the timing differences between the revenue costs incurred by the Council and the timing of the loan repayments will need to be funded by the temporary use of the Commercial Risk Reserve. This is not expected to impact on the financial risk profile of the Council's outcome driven commercial activity, given the expected phasing over the medium term of investments in WPDG will be after temporary allocations are due to be repaid.

83. The focus of the governance arrangements will be not only about making the right investment decisions, based on the applications received, but also ensuring the overall financial viability of the WRIF at the point those individual decisions are made. The release of funding only when individual applications are agreed will help in managing the downside financial risk.

84. However, there is always a risk that default rates will be higher than assumed in the modelling, and these will need to be financed. The £7.5m

Commercial Risk Reserve created as part of the 2021/22 MTFS refresh will provide a level of capacity to manage the downside risks across our commercial portfolio. This provides further comfort that the crystallisation of the downside financial risks will not undermine the MTFS.

Impact on the Annual Financial Cycle

MTFS

85. The MTFS sets out how the Council intends to meet its financial commitments and assesses the actions necessary to prepare a balanced budget. The working assumption that the WRIF will be delivered at a net positive revenue benefit to the Authority means there is no requirement to identify budget capacity for the WRIF in the 2021-26 MTFS. If any additional costs above those in the report are needed these would be expected to be covered as a first call on surpluses generated by the WRIF.

86. This financial impact of the WRIF on the MTFS is set out in the table below.

	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m
Cumulative PWLB interest	0.182	0.790	1.187	1.426	1.580
Interest on cash foregone	0.004	0.013	0.014	0.016	0.017
Provision for defaults	0.033	0.279	0.449	0.427	0.396
Administration costs	0.298	0.564	0.564	0.564	0.564
Arrangement fees	(0.110)	(0.110)	(0.110)	(0.110)	(0.060)
Loan repayments	(0.145)	(1.493)	(2.511)	(3.132)	(3.565)
Impact on MTFS	**0.262**	**0.043**	**(0.407)**	**(0.809)**	**(1.068)**

87. To operationalise the WRIF the financial limits built into the Treasury Management and Investment Strategies will require Council to re-approve amended strategies. This is currently timetabled for July 2021. Generally, these core financial risk management strategies should not be viewed as being flexible to accommodate whatever policy proposals are brought forward for consideration. The independence of these strategies from specific policy/political priorities is an important control. Amending the strategies in-year is necessary on this occasion because the project was still in development when the strategies for 2021/22 were agreed in February 2021. It is expected that any future amendments will be incorporated in the refreshed strategies approved as part of the budget in February each year as part of being able to continue to demonstrate our financial plans are robust, prudent and sustainable.

88. At this point in time the £140m figure for investment in the WRIF over five years is considered to be the upper limit of what is affordable and reasonable to invest. Within this overall £140m figure for WRIF, a cap of £90m has been allocated for the Business Investment Growth pillar which has the lowest risk and strongest return, with a much lower £10m cap set for the higher risk Local Communities and Enterprise Pillar to minimise the risk of ‘losses’ on that pillar and ensure the overall WRIF makes a positive return, is affordable and takes account of the Council’s fiduciary duties. There is a £40m cap for Property and Infrastructure Investment Fund.

Financial Monitoring and Accounting

89. The approach proposed in the Business Plan aims to match the costs of the WRIF with a revenue return that should offset their impact. This will need to be carefully monitored on an on-going basis to ensure this is the case. If not, these costs will need to be financed from other County Council resources and pro-active decisions made about future lending activity where lessons are learned, in particular it will be critical that the authority does not “double down” on an investment or type of investment that experience demonstrates is not achieving its objectives; this ability to make timely and robust decisions where action is needed is a key lesson learned from other local authority public interest reports.

90. In particular, if there is any indication from the regular financial monitoring that any business funded through the WRIF will not be in a position to meet its loan repayments the Council will need to consider how to make good any loss. The Council will need to consider whether the Commercial Risk Reserve is sufficient to mitigate this risk on an annual basis.

91. Given the potential impact of the WRIF on the MTFS financial monitoring of the overall performance of the WRIF will be a key element of the financial oversight and scrutiny. This scrutiny and oversight should ideally be independent from the decision-making about which applications to recommend for approval. These separate roles and responsibilities from reporting to the Investment Panel and the Member Oversight Group are clearly set out in the WRIF governance arrangements. In particular the Strategic Director for Resources (and S.151 Officer) has deliberately been excluded from the individual investment decision making process to enable him to retain oversight of the overall performance of the WRIF and take remediation steps as considered necessary from an independent stand-point.

92. All the allocations made through WRIF will show as assets (for equity) or long-term debtors (for loans) on the Authority’s balance sheet. Separately to the consideration of monitoring information, at the end of each financial year the Council will be required to commission a valuation of both the Council’s loan book and equity

investment made through the WRIF. This is part of the provision for the cost of expert advice included in the assessment of the WRIF running costs. If there is any indication, as a result of these valuations, that the businesses funded through the WRIF will not be in a position to meet their loan repayments and/or the financial strength of the company indicates a reduction in the value of the Council's shareholding this will mean the Council has to impair the assets on its balance sheet and, depending on the nature of the reduction in value, may be required to make good any reduction in value. This has the potential to impact directly and immediately on the Council's revenue spending capacity.

93. The final reason why the robustness of the monitoring arrangements is important for the Council's overall finances is the potential VAT impact. Income from loans and investments is accounted for as 'exempt income' for VAT purposes which generally means that no VAT can be recovered on costs of generating this exempt income. The Council (like all local authorities) has a special arrangement with HMRC where VAT incurred on the costs of generating such exempt income can be reclaimed from HMRC but this is limited to an annual amount. Costs for services relating to the WRIF such as external advisors, will be included in this calculation and therefore this position will require close monitoring to ensure the Council does not breach the limit.

Risk and Risk Management

94. The following table summarises the key risks and proposed mitigations involved in setting up and operating the WRIF.

Risk	Mitigation
Fiduciary duties (PWLB, Prudential Code)	• Annual Cabinet review and decision making • Legal and specialist Treasury Management advice supports creation of Fund • Engagement with external auditors • Member Oversight Group and role of other member bodies (eg Audit and Standards Committee/OSC)
Compliance with Subsidy Control regulations	• Regular monitoring to ensure compliance as part of due diligence and investment business case prior to investment decision making

Default/loss, bad debts, interest rates	• Securitisation of loans and use of specific points enabling WCC to recover its investments • Investment Panel, chaired by the Strategic Director for Communities, due diligence to inform investment recommendations • Diversified and balanced portfolio of investments to mitigate risk • External advice to support sound running of WRIF, including to manage impact of changes in interest rates • Provision of business support to ensure strong, investment-ready proposals come forward
Impact on MTFS	• Ability to start small and build the fund up slowly with ongoing review of impact on MTFS of external/internal borrowing • Prudent accounting by including default assumptions in the business case and plan • Annual review and annual business plan approval by Cabinet, effectively an annual 'continue/stop' decision • Creation of £7.5m commercial reserve to cover any losses from WRIF, WPDC and other commercial activity
Reputational	• Policy-driven objectives underpin WRIF, with clear strategic priorities to drive investment decisions • Annual review and approval of business plan • Clear performance framework and benefits to track impact of WRIF • Member Oversight Group meets quarterly to review performance and operation of the WRIF • Annual Cabinet review/continue decision point
Skills and capability	• Likely mix of internal/external provision to run the WRIF • Appointment of specialist staff in Finance and Communities teams

Regulatory	• Where any products are likely to require FCA registration (most probably products within the LCEF) external fund management will be sourced

Background Papers

None

	Name	Contact Information
Report Authors	Chris Kaye Richard Ennis	01926 412836 chriskaye@warwickshire.gov.uk richardennis@warwickshire.gov.uk
Assistant Director for Finance Assistant Director for Legal	Andrew Felton Sarah Duxbury	01926 412441 andrewfelton@warwickshire.gov.uk 01926 412090 sarahduxbury@warwickshire.gov.uk
Strategic Director for Resources	Rob Powell	01926 412564 robpowell@warwickshire.gov.uk
Portfolio Holder (Finance and Property)	Peter Butlin	01788 816488 cllrbutlin@warwickshire.gov.uk

The report was circulated to the following members prior to publication:
Local Member(s): none