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CYFLWYNIADA

Pwyllgor PWYLLGOR CRAFFU'R ECONOMI A DIWYLLIANT

Dyddiad ac amser y cyfarfod DYDD MAWRTH, 21 TACHWEDD 2023, 4.30 PM

Os gwelwch yn dda gweler ynghlwm y Cyflwyniad(au) a ddarperir yn y Cyfarfod Pwyllgor

7 **Strategaeth Ariannu Arena Dan Do**(*Tudalennau 3 - 10*)
Craffu cyn penderfynu.

Nid yw Atodiadau 1 & 2 yr adroddiad hwn i'w cyhoeddi gan eu bod yn cynnwys gwybodaeth eithriedig o'r disgrifiad a gynhwysir ym mharagraffau 14 ac 16 o Ran 4 a pharagraff 21 o Ran 5 o Atodlen 12A i Ddeddf Llywodraeth Leol 1972.

Mae'r dudalen hon yn wag yn fwriadol

Arena Funding Strategy

Economy & Culture Scrutiny

21st November 2023

Recent / Current Cabinet Decisions

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1. July 2023 (Cabinet Approved)

- a) **Approved entry into Arena Development & Funding Agreement (DFA) Legal Documents** – Subject to approval of Funding Strategy in November 2023
- b) **Extension and Variation to Pre-Contract Service Agreement (PCSA)**– This decision allowed Council more time to determine affordability of arena and develop a revised Funding Strategy. Also committed Council to additional PCSA underwrite, albeit no increase in costs if Arena proceeds, only if Council walks away.

2. November 2023 (Final Cabinet Decision)

- a) **Approve Funding Strategy & Enter DFA** – If Cabinet approve funding strategy Council enter into DFA. This acts as final sign-off for delivery of Arena and entry into 46-year contract subject to conditions being met (primarily land appropriation, stopping up & MSCP)
- b) **Or Walk Away** – If Arena deemed unaffordable or too risky, Council can still walk away without any further legal or financial commitments, but will incur abortive costs (details of abortive costs set out within Confidential Appendix 2)

3. May/June 2024 (Financial Close – Subject to Certain Conditions being met)

Economic & Interest Rate Outlook (LINK Forecasts)

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

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- LINK analysis indicates whilst Bank of England and PWLB rates are high at the moment, rates are likely at, or very close to, their peak.
- LINK analysis seems to be an expectation rates will follow downward trend over the coming months / years, with Capital Economics forecasting 25 year PWLB rates to be 4.1% by March 2026 (furthest forecast out) and LINK projecting rates to be 3.8% by December 2026. This trend is supported by wider market views, albeit some differences of opinion amongst experts on exact timings
- Naturally, there is upside risks to the forecast in the near term, especially if inflation does not come down meaning Bank Rate is left higher than anticipated, leading to higher near-term gilt yields and in turn PWLB rates.
- Proposed Funding Strategy - doesn't seem sensible to lock into long-term fixed rates now at the likely peak of interest rates

Proposed Financial Strategy

- 1. Temporary Borrowing Now** - When signing DFA utilise Temporary Borrowing solutions to fund initial costs. Financial model currently assumes short-term temporary borrowing during 3-year Arena construction period, although Council will continue monitoring markets and retains flexibility to adapt strategy as required
- 2. Fix Later When Rates are Lower** - S151 to continually monitor PWLB rates and other potential funding options throughout Arena construction period, with a view to entering into a more long-term borrowing arrangement at fixed interest rate either once Arena is operational (year 4 onwards), or at such a time when s151 officer, in their professional judgement, and after considering the latest treasury management advice, concludes entering into long-term funding arrangements is most appropriate and affordable for the Council.
- 3. Monitor Risks** - Clearly there are risks associated with this financial strategy (including interest rates, RPI and MSCP income), so a healthy contingency will need to be set aside to deal with this (Council needs to plan ahead now and put appropriate mitigations in place rather than reacting after signing DFA)

Funding Strategy - Key Principles

The proposed funding strategy is based on Five Key Principles:

- 1) **Borrowing Profile** - Temporary Borrowing throughout Construction Period (3 years), with a view to entering into a more long-term borrowing arrangement at fixed interest rate either once Arena is operational (year 4 onwards), or at such a time when s151 officer, in their professional judgement, and after considering latest treasury management advice, concludes entering into long-term funding arrangements is most appropriate and affordable for the Council.
- 2) **Review/Amend Accounting Policies** – Consider reviewing and amending Council Accounting Policies to enable Capitalisation of Interest for significant Major Projects such as Indoor Arena, as well as to allow for an MRP holiday for this project. This will assist the Council in matching costs to income and make delivery of Arena more affordable and sustainable.
- 3) **Reduce Debt Burden Early** - Utilise specific earmarked reserves and MTFP budgets allocated for Arena to reduce debt burden as far as possible in early years, particularly during construction period where interest is being capitalized. This will reduce annual revenue cost of debt, but needs to be balanced against retention of budgets/reserves for financial resilience purposes.
- 4) **Maximise Risk Mitigations** – Be proactive in taking risk mitigation measures to improve financial resilience of Council and continue to manage the affordability risk.
- 5) **Milestone Reviews** – Commit to undertaking gateway reviews re Arena funding annually, or at appropriate milestone dates, particularly in the early years until financing model becomes smoother and risks are sufficiently reduced. This will help identify whether any further mitigating actions are required

Three Key Risks to Financial Model

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- 1. Interest Rate Risk** – Inherent risk as heavily dependent on rates we can borrow at. We've done what we can to come up with Finance Strategy to help mitigate these risks as far as possible, but further steps may be required (see later slide)
- 2. RPI Risk** – Financial model assumes RPI will be 2.5% flat throughout 46-year contract. Reality will be different we know, but we feel prudent assumption. Only 4 years in past 20 has RPI been below 2.5%, with majority of years either equal to or substantially higher than 2.5% RPI.
- 3. MSCP Income Risk** – Multi-Storey Car Park business case is not due to be presented to Cabinet until January 2024, so there remains a level of uncertainty regarding levels of net income to be generated by MSCP.

The majority of funding risk is in relation to enabling works and the MSCP development and income streams, which represents a lesser proportion of overall Council investment (circa 20%) than the Arena itself (80%).

Potential Risk Mitigations

For reasons outlined on previous slides, Council cannot be over reliant on the financial model projections materialising, so will need to put mitigating actions in place in short-term in case there is deviation from this scenario.

Potential mitigations could include, but are not limited to:

- **Generating additional capital receipts** to to further pay down debt and continue to de-risk financially, which in turn will reduce annual costs of debt that need to be met from Council's revenue resources
- **Identify additional sources of revenue income within Atlantic Wharf**
- **Constrain future borrowing/investment that results in additional risk exposure** on other Major Projects in medium term until Council has greater certainty on affordability and sustainability of Arena/MSCP costs and income proposals.
- **Take opportunities to pay down Arena, MSCP and enabling works debts wherever possible**, albeit striking a balance between reducing debt as early as possible and retaining some financial resilience within reserves to meet future unexpected pressures or demands.
- **Identify suitable Earmarked Reserves as a contingency** for utilisation (if and when required)
- **Review and update Council's accounting policies** to enable capitalisation of Interest and MRP holiday in specific circumstances such as a significant major project such as the Arena. This will assist the Council in matching costs to income annually to make delivery of the Arena (and similar future projects) more affordable and sustainable.

Summary

- Financial model indicates potentially affordable pathway for delivery of Arena, albeit this requires some additional funding to be identified in short-medium term and increase in Council's risk exposure
- If financial model outcomes materialise, Arena is forecasted to be self-funding in long term
- However, Council would need to incur additional costs in short-term (i.e. existing MTFP budgets + identified additional funding requirement) to deliver Arena and unlock associated benefits in longer term (both financial and non-financial). The additional funding requirement can be funded from within an existing earmarked reserve.
- Remain clear risks to this approach, including gaps in robustness in some areas of base business case (mainly MSCP income & reliance on future Cabinet decisions and external developers delivering). Economic environment remains uncertain so risk mitigation measures are essential.
- S151 recommended approach would be to constrain future borrowing or further Council investment that results in additional risk exposure on other Major Projects in the medium term (excluding where prior agreement has been given) if Cabinet support proceeding with Arena as Anchor Project (due to economic and financial risk exposure)