CARDIFF COUNCIL CYNGOR CAERDYDD

CABINET MEETING: November 2023

Indoor Arena Funding Strategy

INVESTMENT & DEVELOPMENT (CLLR RUSSELL GOODWAY)

FINANCE, MODERNISATION & PERFORMANCE (CLLR CHRIS WEAVER)

AGENDA ITEM:

PORTFOLIO: INVESTMENT & DEVELOPMENT

Appendices 1 and 2 of this report are not for publication as they contain exempt information of the description contained in paragraphs 14 and 16 of Part 4 and paragraph 21 of Part 5 of Schedule 12A of the Local Government Act 1972.

Reason for this Report

1. To consider the Funding Strategy for the new Indoor Arena project

2. Seek authority to enter into and execute the DFA suite of legal agreements previously approved by Cabinet in July 2023 (subject to approval of funding strategy)

Background

3. Delivering a new Indoor Arena remains a key strategic regeneration priority for the Council, supporting a number of Corporate Plan commitments, Council priorities and strategies, including:

    - Attracting more visitors to the city that stay longer.
    - Supporting growth in the local economy and creating jobs
    - Supporting the next phase regeneration of Cardiff Bay
    - Eliminating poverty and promoting equality
    - Promoting culture and creativity
    - Supporting the Cardiff Music Strategy

4. The Arena project will provide a substantial number of new jobs, both through the construction phase, and through its long-term operation. The Arena will be located in close proximity to many of Cardiff's most disadvantaged communities. Through the procurement process to appoint an operator/developer consortium to deliver the new Indoor Arena, the Council has secured a number of local community benefits as outlined in previous Cabinet reports (November 2020).

5. In July 2019, Cabinet gave authority to commence a public procurement process to secure a developer/operator consortium to deliver an Indoor Arena at Atlantic Wharf, Butetown with a minimum capacity of 15,000 as part of a wider regeneration strategy for Cardiff Bay. The Council subsequently launched a competitive tendering exercise in August 2019.

6. In November 2020, Cabinet approved the appointment of the Live Nation consortium as the Preferred Bidder in the procurement process to deliver a new Indoor Arena in Butetown, Cardiff Bay. At the same meeting Cabinet gave authority for the Council to enter into a Pre-Contract Service Agreement (PCSA) which included the under-writing of costs up to an agreed cap to enable the Preferred Bidder to develop detailed designs. Cabinet authority was also provided to progress a Land Strategy to ensure the Council secures full control of all land required to deliver the project.

7. In September 2021, Cabinet approved a Full Business Case for the delivery and operation of a new Indoor Arena and delegated authority to enter into the various legal arrangements.

8. In March 2022, outline planning permission was granted for the Atlantic Wharf site alongside detailed permission for the new Indoor Arena.

9. In March 2023, Cabinet considered a progress report on the Atlantic Wharf regeneration scheme and approved the extension of the Pre-Contract Service Agreement (PCSA) for the Arena, as well as an Interim Business Case for the associated Multi-Storey Car Park.

10. In July 2023, Cabinet approved an extension and variation to the Pre-Contract Service Agreement (PCSA) for the delivery of the new Indoor Arena. At the same meeting Cabinet approved the Development and Funding Agreement (DFA) as well as any further deeds and documents ancillary to the legal documents approved, with entry into the DFA remaining subject to approval of the funding strategy at a future meeting of Cabinet. This report focusses on that proposed Funding Strategy to enable entry into the previously approved DFA suite of legal agreements.

11. The pause in entering the DFA provided the Council with further time to review and agree a financial strategy to mitigate the current interest rate uncertainty. Whilst Treasury Management Activities are delegated to S151 Officer, it is important to bring a specific report on this significant Council project to highlight the proposed approach and principles to manage finance resilience and risk as part of a sustainable budget framework.

Issues

12. As previously reported to Cabinet, inflationary pressures have pushed the cost of the new Indoor Arena from the projected figure of £180m to close to £280m. The Council's financial exposure/liability (established via a financial envelope as part of the original public procurement process) is capped and therefore the Live Nation consortium has had to take full responsibility for these additional costs.

13. The Live Nation consortium has successfully worked to reduce the level of cost increase through a review of the Arena design and reconsideration of site infrastructure requirements. The design has now been developed to RIBA Stage 3, including cost plans, which indicate that the scheme is now within the Live Nation consortium's revised affordability envelope, and importantly without any additional financial contributions from the Council. However, the redesign has caused an unavoidable delay to the programme, with the intention now to commence with an advance works package in early 2024, with the main works starting in Summer 2024, subject to entering into the DFA.

14. Whilst the level of Council funding for the project has remained unchanged, these unavoidable delays in delivery have coincided with a significant increase in the Council's cost of borrowing over the last 12-18 months. This increase in borrowing rates has caused financial challenges as the cost of funding the Arena has increased, reducing the gap between income received by the Council and debt repayments required over the whole term of the Arena lease, and generating cashflow and accounting challenges in managing the Council's short term financial position.

15. As such, the Council deferred a decision from July 2023 to allow sufficient time to work on and agree a suitable funding strategy that will help manage the Council's short-term position, whilst allowing a longer-term strategy to be entered into when interest rates become more favourable. Details of the Council's revised funding strategy are set out within this report, as well as in more detail within **Confidential Appendix 2**.

<u>LINK Report Summary</u>

16. The Council's Treasury Advisors (LINK) have produced a report which is attached at Confidential Appendix. This report sets out:

- **Economic & Interest Rate Outlook** - Link Group analysis on current economic conditions, including a forecast on interest rates between now and December 2026.
- **Authority's Current Capital Financing Requirement**
- **Borrowing Policy and Options Available** (including pros and cons of each mechanism for borrowing). Proposed Funding Strategy focuses on best options identified within this section of LINK report.
- **Accounting and Statutory Issues to Consider –** This includes options re capitalisation of interest and timing of application of MRP (Minimum Revenue Provision) to revenue budgets.
- **Financial Modelling of Scenarios** (before any Council mitigations are considered).

Note that the LINK report attached at **Confidential Appendix 1** focusses on financial scenarios prior to any Council mitigations being applied. **Confidential Appendix 2** then translates this into what the LINK report means for the Council, looks at any additional budget requirements as well as detailing further mitigating measures to enable delivery of the Arena in a sustainable and affordable manner.

<u>Economic & Interest Rate Outlook</u>

17. LINK Group analysis indicates that whilst Bank of England and PWLB rates may be high at the moment, they are likely at, or very close to, their peak. This is based on the interest rate forecast and projection for gilt yields over the coming years on forecasts from LINK, Capital Economics, and a general market consensus from Bloomberg. The clear trajectory from LINK rate forecasts seems to be an expectation rates will follow a downward trend over the coming months / years, with report attached at **Confidential Appendix 1** stating:

> *"Both Capital Economics and Link forecast gilt yields to fall in the years ahead as inflation is forecast to come down meaning gilt yields will follow the path down in rates. Capital Economics forecast the 25-year Public Works Loan Board (PWLB) rate to be 4.10% ending March 2026 (latest forecast point) and Link forecast it to be 3.8% ending December 2026 (at time of report in October 2023 PWLB rates are circa 5.5%). Historical data from the PWLB shows the 25-year PWLB rate has averaged c3.9% since 1994 to 2023 which is very close to the Capital Economics and Link forecast over the next few years. 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."*

18. For this reason, whilst locking in to long-term borrowing at the same time as signing the DFA brings some benefit to the Council in terms of greater financial certainty (Council fixes borrowing costs at same time as locking in Arena income by signing DFA), based on the available market evidence it no longer seems a logical choice for the Council to lock into a fixed rate of interest for the significant long-term borrowing required to deliver the Arena when current market analysis strongly indicates that interest rates are currently at or near their peak.

19. Whilst entering into the Arena DFA without a fixed cost of borrowing does represent a risk to the Council as interest rates are unlikely to exactly follow the LINK forecasted rates set out in **Confidential Appendix 1**, and could move at faster or slower pace, or even not follow a downward trajectory at all, this is deemed to be a calculated risk as it is widely accepted based on current market analysis that interest rates are likely to fall in the medium term (2-3 years).

<u>Proposed Funding Strategy</u>

20. The current economic environment remains uncertain and therefore risk mitigation measures are essential for any funding strategy the Council puts in place. At current interest rate levels, the current financial model forecasts remain a risk, particularly if interest rates continue to stay higher for longer than market experts are currently forecasting, so mitigations are essential. There will always be economic uncertainty on key variables such as inflation over the term of the project (46 years) but prudence, affordability and sustainability requires Council to ensure these risks are identified and managed at the start of the project, rather than many years in the future, and that is what the Council's financial strategy, and the key principles laid out within this report, is seeking to achieve.

21. The proposed funding strategy is to focus on temporary borrowing arrangements during the three year construction phase of the Arena whilst the Council continues to

monitor the interest rate market, with a view to entering into a more long-term borrowing arrangement at a fixed interest rate either a) once Arena is open and operational, or b) at such a time when the 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.

22. This strategy is different to previous options considered in that it would mean the Council carrying interest rate risk after signing the Arena DFA. However, a balance is required between certainty of rates and affordability if the Arena Affordability Envelope is to be met.

23. This long-term strategy for managing the interest rate risk prior to entering the DFA offers a potentially affordable pathway for delivery of the Arena. However, clearly there remain risks associated with this financial strategy, as with delivery of any project of this complexity and magnitude. For these reasons it is important that contingencies are identified within budgets or earmarked reserves that can be utilised if required to deal with any potential deviations from the forecasted business case e.g., if interest rates do not fall as expected in coming years.

Key Principles

24. The proposed funding strategy is based on a number of key principles. These are:

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 the s151 officer, in their professional judgement, and after considering the latest treasury management advice, concludes entering into long-term funding arrangements is 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 allowing for a Minimum Revenue Provision (MRP) holiday for this project. This will assist the Council in matching costs to income and make delivery of the Arena more affordable and sustainable.

3. **Reduce Debt Burden Early** - Utilise specific earmarked reserves and MTFP budgets allocated for the Arena to reduce the debt burden as far as possible in early years, particularly during construction periods where interest is being capitalised. This will need to be balanced against retention of budgets/reserves for financial resilience purposes.

4. **Risk Mitigation –** Be proactive in taking risk mitigation measures to improve financial resilience of the Council and continue to manage the affordability risk.

5. **Milestone reviews –** Commit to undertaking gateway reviews in respect of Arena funding annually, or at appropriate milestones, particularly in the early years until the financing model becomes smoother and risks are sufficiently

reduced. This will also help to identify whether any further mitigating actions are required.

MTFP Budgets

25. A base budget provision of £1.5m in already in place to fund the annual revenue costs of borrowing associated with the Indoor Arena, with increases already factored into the Council's Medium Term Financial Plan (MTFP) for this to increase in the short-term to £2.9m during the construction phase and early years of the project (to cover initial debt repayments and interest costs). This base budget will be retained in the medium-term to assist in smoothing cashflows in the early years of the project, with the Council expected to need to incur additional costs in the short-medium term to deliver the Arena and unlock associated benefits in the longer term, both financial and non-financial. Intention is this base budget will be removed or reallocated when Arena costs and income equalise in medium-term. Whilst these budgets assist the Council in dealing with short-medium term cashflow issues, in the long-term the Arena is forecasted to be self-financing.

Council Capital Contribution to Arena

26. The Council originally budgeted £30m as the Council contribution towards the cost of delivering a new Indoor Arena. However, as set out within the November 2020 Cabinet report, and the Arena Full Business Case approved by Cabinet in September 2021, the maximum level of capital contribution required was fixed as part of the bidders' final tender submissions and was less than the original £30m budget. This capital contribution is included within the Capital Strategy approved by Cabinet in February 2023 and Full Council in March 2023 and is due to be funded by a mixture of capital receipts and borrowing.

Council Funding (Self-Financing)

27. In addition, an allowance has already been included within the Capital Strategy approved by Cabinet in February 2023 and Full Council in March 2023 to enable the Council to 'Direct Fund' the Arena construction on a self-financing basis. This will take the form of direct borrowing funded by the annual lease income from the Arena Operator and backed by a parent company guarantee. Similarly, the approved Capital Strategy also makes provision for Arena enabling works (including land assembly and Multi Storey Car Park) to be self-funded by income generated by the Multi Storey Car Park.

Arena Financial Model

28. LINK forecast for 25-year PWLB certainty rate (the rate at which the Council can borrow) is for it to be circa 5.1% by June 2024 (the point at which Council is likely to reach financial close on Arena). On this basis, prudent modelling has been done assuming a 5.5% interest rate for temporary borrowing in first year after financial close until end of construction period (3 years), with similarly prudent rates applied in years two and three of the financial model. Over the next 24 months though the trajectory is for rates to fall, with a forecast PWLB rate of circa 3.8% in June 2026. For the purposes of financial modelling, this is the long-term fixed rate of borrowing that has been

assumed the Council will lock in to for business case purposes (albeit will be monitored and reviewed by the s151 officer throughout the period).

29. There are a number of key assumptions within the model. These are set out in detail in **Confidential Appendix 2**, along with a detailed set of forecasted outcomes. Based on these assumptions, and the likely profiles of spend, borrowing and income, the financial model forecasts the Arena will be self-financing over the term of the 46-year contract. However, in order to achieve long-term financial benefits, the financial model forecasts there will be a need for short-term additional funding requirements on top of the existing planned MTFP budgets, expected to be circa 4 years. This forecasted short-term additional funding requirement can likely be funded from within existing earmarked reserves.

<u>Key Risks</u>

30. The three key risks identified within the model are set out below, along with a series of potential mitigation measures:

1. **Interest Rate Risk (Costs)–** An inherent risk is the level of interest rate the Council borrows at to fund the Indoor Arena, and therefore the annual repayment costs of such borrowing to the Council. All borrowing costs are intended to be self-financing in the long-term from Arena Operator Rental income, and in the financial model forecast this materialises with a surplus for the Council anticipated at end of the 46-year contract. However, there remains a risk that if interest rates remain higher for longer this will negatively affect that outcome. Several mitigating measures are proposed within this report and appendices to minimise the risk to the Council. Also, in the early years of the Arena contract when borrowing costs are at their highest and Operator Income is at its lowest (Arena Rental rises annually with RPI, whereas borrowing costs don't), there is anticipated to be some short-term funding requirements for the Council to meet (where costs are higher than income). This is projected to be only a short-term issue, and mitigating measures are proposed within **Confidential Appendix 2** *(pay down debt early, use reserves and MTFP budgets to meet any shortfalls etc)* to manage these expected short-term cashflow shortfalls.

2. **RPI Risks (Income) –** The income the Council receives from Arena Operator as rent will increase annually by between 1% and 4% (collar and cap) based Retail Prices Index (RPI) throughout the long-term contract. The Arena base financial model assumes RPI will be 2.5% flat throughout 46-year contract, and therefore that is what it is assumed annual income will rise by each year. Whilst in reality RPI will differ each year, it is felt that an average increase of 2.5% annually over a 46-year period is a prudent assumption. For context, 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. If RPI is lower than 1% in any given year, then 1% increase will apply (RPI floor). Similarly, if RPI is higher than 4% in any given year a maximum 4% increase will apply (ceiling) to Arena rental income.

3. **Multi Storey Car Park (MSCP) Income Risk**– The MSCP business case is not due to be presented to Cabinet for consideration until early 2024, so there remains a level of uncertainty regarding levels of income to be generated here. Working assumptions include that the Council will manage the MSCP and retain all net income, whilst current financial model assumes a build-up of demand for parking in Atlantic Wharf over the first 7 – 10 years of operation. This is linked to Arena opening, but also the potential future development and regeneration of Atlantic Wharf which would generate increasing demand for car parking. Whilst some prudent assumptions have been made in forecasting net income, a key risk remains that if the proposed Atlantic Wharf development doesn't materialise, or does materialise but at a much slower pace (takes more than 7 years) than currently proposed or anticipated, this could cause some lag in forecasted net income numbers, or in a worst case scenario never reach the income estimates that are currently included in the financial model. These decisions on Atlantic Wharf haven't been made yet, so remain a key risk to overall financial model and business case. A business case for the MSCP and the next steps for Atlantic Wharf redevelopment is due to be presented to Cabinet in the coming months. However, at present, there is a gap in robustness for the MSCP income assumptions included within the current financial model as Council do not currently have sufficient information or decisions to reliably estimate what this will be.

31. For these reasons, the Council cannot be over reliant on the current financial model forecast materialising and will need to put mitigating actions in place in case there is deviation from this scenario. Potential mitigations need to be identified and reviewed, and steps should be taken in the short term by the Council to mitigate some of risks identified. Potential mitigations could include, but are not limited to:

- Generating additional capital receipts 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
- 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.
- 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 more affordable and sustainable.

32. In making a proactive decision to approve the funding strategy and deliver the Indoor Arena, Cabinet is prioritising investment and borrowing in the Arena. This could have wider implications such as needing 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). It is therefore recommended the Council move towards more developer led solutions for Major Projects that do not rely on the Council increasing its levels of borrowing or risk exposure further until Council has greater certainty of affordability and sustainability of Arena/MSCP costs and income proposals.

33. Whilst there remain risks, particularly in relation to relative uncertainties associated with wider Atlantic Wharf developments and knock on effect this could have on MSCP income streams, it is critical to note that the majority of the Council's initial investment is being used to support Arena construction which represents circa 80% of the overall Council investment. This element is supported by a long term, highly rated income stream (including a parent company guarantee) that will pay back this element of the investment, so should give greater confidence in relation to the overall funding strategy. 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%).

34. If the financial model forecasts materialise, the financial implications of the project can be managed within the existing allocated Capital budgets and MTFP allocations already set within the budget. Any forecasted short-term additional funding requirements can be funded from within existing earmarked reserves and repaid from later surpluses with no additional MTFP budget allocations expected to be required. However, for prudence, a contingency budget has been identified within earmarked reserves that can be utilised as required if/when key risks materialise e.g., interest rates do not fall in coming years. If these risks do not materialise, these provisions are able to be released back into reserves for other purposes. Further details of such contingency plans are set out within **Confidential Appendix 2.**

<u>Cost of Not Progressing with Arena Delivery</u>

35. The costs of delivering the Arena are set out within the body of the report above, as well as within **Confidential Appendix 2** of this report. However, if the Council opted at this stage not to proceed with funding and delivery of the Arena, there are costs associated with that too.

<u>Direct Costs of Not Proceeding with Arena</u>

36. If a decision was taken not to sign the DFA and proceed with delivery of Arena, for affordability or any other reason, this is likely to result in direct abortive costs being charged back to revenue. Estimated Abortive Costs are set out within **Confidential Appendix 2** and include:

- **Arena PCSA Underwrite** – This is a penalty clause within the Pre-Contract Services Agreement the Council has signed with Developer/Operator and would become payable if the Council opted not to proceed with arena for any reason, but the Developer/Operator wished to continue. This cost would be to reimburse Developer/Operator for their costs to date, up to the pre-agreed cap, including Detailed design work on Arena, submission of Planning Permission etc. This would become an immediate abortive cost to the Council.

- **MSCP PCSA Underwrite** – Similar to above, this is a penalty clause within Pre-Contract Services Agreement the Council has signed with Contractor appointed for Multi Storey Car Park delivery if the Council decided not to proceed with construction for any reason, but the contractor wished to continue. This would become an immediate abortive cost to the Council.

- **Council Enabling Works** - In addition, the Council has already incurred/committed costs in progressing to this point of delivery for Arena. These enabling works costs includes land assembly, release of covenants on County Hall site, professional fees, surveys etc. Whilst some of this could be deemed to remain a relevant asset e.g., land acquisitions, a significant proportion would likely become abortive and result in an abortive cost needing to be charged to revenue budgets in-year.

Programme and Next Steps

37. Subject to Cabinet approval of the funding strategy, the next stage of the process is to enter into the Development and Funding Agreement (DFA) with Live Nation consortium with a view to achieving Financial Close, and the Arena delivery contract becoming unconditional. Financial Close can only be achieved once RIBA Stage 4 is completed and a contractor is procured providing a final price. Financial Close is anticipated to occur in Summer 2024, with enabling works starting earlier in January 2024.

38. The indicative programme is set out below:

- December 2023 - Sign DFA (conditional)
- January 2024 - Commencement of Enabling Works
- May/June 2024 - Financial Close (signing of Lease unconditional)
- June 2024 - Main Arena Construction Works to start.
- Late 2026 - Arena Opening

Reason for Recommendation

39. To confirm entry into Development & Funding Agreement and associated suite of legal documents with Live Nation Consortium for delivery of the Indoor Arena

Financial Implications

40. The report sets out a revised funding strategy for enabling the Arena development, the first phase of the overall Atlantic Wharf Master Plan. The report includes detail on the approach to borrowing funds from different sources, interest payable on this borrowing. This borrowing is a consequence of Council's decision to undertake capital expenditure toward the project.

41. Various Cabinet reports are referred to where financial implications of undertaking that capital expenditure have been provided as part of business cases considered by Cabinet in the development of the project. That capital expenditure relates to: -

- £138.1 million of direct funding towards the arena construction of the indoor arena in exchange for an index linked lease income deemed a strong covenant. Whilst Council is providing up-front funding here, repayment of borrowing is funded by

Arena Operator via annual lease payments to Council over course of 46-year contract.

- £27.3 million Council contribution to the Arena development, assumed to be paid for from earmarked capital receipts and Council borrowing.
- £46.0 million enabling works including a new Multi-Storey Car park assumed to be self-funding from parking income.

42. In respect to the Multi Storey Car Park, its dependencies on income from the existing and further phases of the Atlantic Wharf Master Plan have not been considered by Cabinet at this stage. The financial strategy proposed here therefore includes assumptions and so represents a risk to be monitored closely. If following consideration of the Multi Storey Car Park business case, it highlights the need for and implementation of any additional mitigations, these should be included as updates to this funding strategy and included in budget proposals.

43. The sums above are included in the capital strategy and investment programme approved by Full Council in March 2023 and will need to be updated with any changes arising from revisions to the funding strategy including additional borrowing to meet interest costs.

44. The detailed financial modelling in **Confidential Appendix 2** and interpretation of this modelling sets out a base case scenario. This sets out the Capital Expenditure, revenue budget impacts, the treasury management and financial policy implications to determine whether the capital investment proposed in the business cases is affordable, prudent, and sustainable. This indicates that over the period of 46 years this is achievable, albeit there are key risks that need to be managed and mitigated. This is an extremely long period of time and Cabinet are referred to the following in considering the approach recommended in this report:

    - The overall financial investment / asset on completion of the first phase, enabling future investment in the City.
    - The risk of abortive costs in the event of not proceeding
    - The recommended approach to temporary borrowing in the short term and fixing any borrowing on the expectation that interest rates will fall based on current external treasury management advice. Whilst entering into the Arena DFA without a fixed cost of borrowing does represent a risk to the Council as interest rates are unlikely to exactly follow the LINK forecasted rates set out in **Confidential Appendix 1**, and could move at faster or slower pace, or even not follow a downward trajectory at all, this is deemed to be a calculated risk as it is widely accepted based on current market analysis that interest rates are likely fall in the medium term (2-3 years).
    - The key risks identified in the report and **Confidential Appendix 2**, namely, Interest Rate, Retail Price Index uplift of income and Multi Story Car Park income.
    - The requirement to make prudent provision for repayment of any capital expenditure incurred over a prudent period of time in line with its agreed Policy.
    - The change in approach to capitalising interest to better match income and expenditure
    - The Council's Borrowing Strategy aims to meet the long-term aims of promoting revenue cost stability to aid financial planning and avoid a stop-start approach

to service delivery, although it is recognised that this may have a financial impact.
- The need for financial mitigations to ensure that long-term borrowing commitments remain affordable now as well as in the medium to long term, to minimise financial resilience risk.

45. The report sets out a number of financial resilience risk mitigations, some of which are clearly identified and others which are items to consider with no data on the achievability or deliverability of such mitigations. Where these mitigations are detailed, these involve: -

- Using the existing and planned revenue budgets in future years of £2.9m towards reducing the level of capital expenditure to be paid for by borrowing, including the decision to capitalise interest.
- In addition, use in 2024/25 of the current Central Enterprise Zone Reserve towards reducing the level of capital expenditure to be paid for by borrowing.
- Re-purposing part of the Treasury Management Earmarked Reserve as a contingency to variations in the financial model forecasts on an ongoing basis.

46. Where the mitigations are not clearly identified or developed, this should be logged as part of any project risk register as mitigations and continue to be reviewed with reporting on outcomes included in project management updates.

47. In the event these contingency measures are not implemented prior to any agreed checkpoints identified, there is a financial risk to the approach set out in the funding strategy. Where deviations to the mitigations set out in the funding strategy are made, these should be clearly set out with risk and financial implications impact considered over the whole term of the project. The report does not set out whom, where and how often the funding strategy performance and progress on the project would be reported. This is essential to ensure consistency as part of the Council's process for budget monitoring and best practices approaches to post project review.

48. The report identifies an accounting policy change to capitalise interest on qualifying assets. This is consistent with approaches in other authorities and the approach has been agreed with Audit Wales. This would allow this, and future transformative projects undertaken by the Council to proceed particularly where there is a significant period of time between construction and operation of the assets. It should be noted that this is not a blanket approach across all capital schemes. The estimated level of interest to be capitalised is £15.5 million over the construction period. This will result in an increase in the capital expenditure investment programme, in addition to that already approved, with mitigations in the short-term aiming to reduce the amount to be spread over future years in order to minimise financial risk. This will need to be updated as part of the budget proposals for 2024/25.

49. Implementation of the funding strategy and associated Treasury Management activities are delegated to the Council's S151 Officer with periodic reports to full Council at the start of the year, mid-year, and end of the year. In the short term, it is proposed specific loans may be ringfenced to the project to allow monitoring and reporting for this specific project. In medium term as loans are then fixed following completion of the construction period, to then consider alignment with the Council's

overall Treasury Management Strategy where loans are not generally taken for specific purposes, but to pay for the capital programme as a whole. This will be subject to ongoing review with relevant Treasury Management advice and delegation to S151 Officer in respect to Treasury Management activities.

50. It should be noted that this project and funding strategy is only part of the overall capital programme and cause of the projected increase in the Capital Financing Requirement to be paid for by borrowing over the next few years. The risks re interest rates and future levels of borrowing and affordability apply to the whole capital investment programme, including housing and investment to improve other assets. The Capital Programme and affordability of the Capital Programme is assessed annually as part of the update of the Capital Strategy and relevant medium term financial plans of the HRA and General Fund. This also includes a statement from the S151 Officer in respect to affordability, prudence and sustainability of the Capital programme having regard to the revenue budget forecasts and certainty of income in respect to schemes proposed such as this project.

51. Whilst there is certainty of income in respect to the majority of proposals in this funding strategy which suggest that the project is affordable over a 46-year period, it is also unclear what further commitments further phases of the Atlantic Wharf Master Plan and other major projects will have on the Council’s own borrowing requirement. In an uncertain economic environment, the strategy proposed does create a financial resilience risk if not mitigated as planned. This will need to be managed closely and consideration be given in the update of the Capital Strategy to limiting further major projects expenditure by the Council and working with partners to deliver further phases, after Council involvement in enabling activities. To do otherwise without certainty following completion of this funding strategy is a significant risk to the affordability, prudence and sustainability of additional borrowing given the council’s existing and emerging capital expenditure pressures.

52. Other significant major projects that the Council is aiming to implement which will need to interlink with the Arena project include Cardiff Crossrail, the Heat Network, the long-term future of the County Hall building, and the potential redevelopment of the Red Dragon Centre which was acquired as an investment. The interlinkages between new Arena and these projects needs to be clear to ensure no financial commitments or liabilities are being entered into by the Council as part of the implementation of Phase 1 and the funding strategy proposed in this report.

53. Whilst the funding strategy is identified for the three main cost areas identified above, the report does not identify any additional costs to the Council, whether revenue or Capital during the implementation of the construction phase; nor in any wider activities to integrate the effective operation of the asset once constructed. In the absence of these not being raised or identified in previous approved business cases, it is assumed that there are no such additional costs to the Council for Phase 1.

Legal Implications

54. Cabinet resolved at a meeting on July 13th 2023 to approve the final terms of the DFA, subject to approval of a funding strategy, which is referred to in the background papers

to this report. As such, this report sets out the Council's proposed funding strategy for the arena project to assist in managing the financial risks of the project in the short and long term. It would be prudent for the decision makers to have regard to the financial risks set out in this report and its appendices prior to entering into DFA.

55. Further external legal advice has been obtained and appended to the report within **Confidential Appendix 2** as an update on previously provided subsidy advice due to the enactment of the Subsidy Control Act 2022.

Equalities & Welsh Language

56. In considering this matter the decision maker must have regard to the Council's duties under the Equality Act 2010 (including specific Welsh public sector duties). Pursuant to these legal duties Councils must, in making decisions, have due regard to the need to (1) eliminate unlawful discrimination, (2) advance equality of opportunity and (3) foster good relations on the basis of protected characteristics. Protected characteristics are: (a). Age,(b) Gender reassignment(c) Sex (d) Race – including ethnic or national origin, colour or nationality, (e) Disability, (f) Pregnancy and maternity, (g) Marriage and civil partnership, (h)Sexual orientation (i)Religion or belief – including lack of belief.

57. When taking strategic decisions, the Council also has a statutory duty to have due regard to the need to reduce inequalities of outcome resulting from socio-economic disadvantage ('the Socio-Economic Duty' imposed under section 1 of the Equality Act 2010). In considering this, the Council must take into account the statutory guidance issued by the Welsh Ministers (WG42004 A More Equal Wales The Socio-economic Duty Equality Act 2010 (gov.wales) and must be able to demonstrate how it has discharged its duty.

58. An Equalities Impact Assessment aims to identify the equalities implications of the proposed decision, including inequalities arising from socio-economic disadvantage, and due regard should be given to the outcomes of a Equalities Impact Assessment, where applicable.

59. The decision maker should be mindful of the Welsh Language (Wales) Measure 2011 and the Welsh Language Standards.

The Well-being of Future Generations (Wales) Act 2015

60. The Well-Being of Future Generations (Wales) Act 2015 ('the Act') places a 'well-being duty' on public bodies aimed at achieving 7 national well-being goals for Wales - a Wales that is prosperous, resilient, healthier, more equal, has cohesive communities, a vibrant culture and thriving Welsh language, and is globally responsible. In discharging its duties under the Act, the Council has set and published well being objectives designed to maximise its contribution to achieving the national well being goals. The wellbeing objectives are set out in Cardiff's Corporate Plan 2020 -23.

61. When exercising its functions, the Council is required to take all reasonable steps to meet its wellbeing objectives. This means that the decision makers should consider how the proposed decision will contribute towards meeting the wellbeing objectives

and must be satisfied that all reasonable steps have been taken to meet those objectives.

62. The wellbeing duty also requires the Council to act in accordance with a 'sustainable development principle'. This principle requires the Council to act in a way which seeks to ensure that the needs of the present are met without compromising the ability of future generations to meet their own needs. Put simply, this means that Council decision makers must take account of the impact of their decisions on people living their lives in Wales in the future. In doing so, the Council must:

- Look to the long term
- Focus on prevention by understanding the root causes of problems
- Deliver an integrated approach to achieving the 7 national well-being goals
- Work in collaboration with others to find shared sustainable solutions
- Involve people from all sections of the community in the decisions which affect them

63. The decision maker must be satisfied that the proposed decision accords with the principles above; and due regard must be given to the Statutory Guidance issued by the Welsh Ministers, which is accessible online using the link below: http://gov.wales/topics/people-and-communities/people/future-generations-act/statutory-guidance/?lang=en

Property Implications

64. The Council have assembled various parcels of land and assets as part of the enabling works referred to in the report. Whilst the assets are currently being managed as vacant land and property, there is a cost to holding vacant assets and whilst due diligence is required to review the funding strategy, any further delays in signing the DFA will only add to practical pressures of managing vacant assets.

65. The report refers in paragraph 31 to the consideration for mitigation in respect of the current financial modelling which includes the generation of capital receipts and income potential from the wider Atlantic Wharf area. The existing assets within the wider area are currently managed and leased to the maximum potential given the current planning and masterplan status offering flexibility for vacant possession or held strategically and vacant for immediate access. The assets have been acquired and managed with a view to providing the Major Project team with as much flexibility as possible whilst retaining an income stream and minimising holding costs to the Council.

66. The work on the business case for the MSCP is currently ongoing and the Estates team will assist and offer any professional advice required a part of any future procurement or marketing of the opportunity for management in order to secure the most robust operating model to capture the income required.

RECOMMENDATION

Cabinet is recommended to:

1) Approve the Indoor Arena Funding Strategy as set out within this report and in more detail at **Confidential Appendix 2.**

2) Authorise entry into and execution of the Development and Funding Agreement (DFA) previously approved by Cabinet in July 2023, and in so doing approve any amendments to the legal documentation as may be necessary, for reasons including but not limited to ensuring consistency between them and finalising any outstanding areas of further deeds and documents which are ancillary to the legal documents approved, subject to consultation with S151 Officer and Legal Officers.

3) To note that, subject to entering in to a DFA with the Arena Developer/Operator and approval by Cabinet of the MSCP Business Case at a future meeting, relevant financial implications will be updated in the Medium-Term Financial Plan, Capital, and Treasury Management Strategies to be consistent with this funding strategy, to form a revised affordability envelope.

4) To note that Treasury Management Activities are delegated to the S151 Officer and implementation and review of this funding strategy will be undertaken as part of the annual updates to the strategy and checkpoints in respect to this project specifically as part of post project review.

SENIOR RESPONSIBLE OFFICER	**Chris Lee** **Corporate Director Resources** **&** **Neil Hanratty** **Director of Economic Development**
	Date

The following appendices are attached:

<u>Appendices</u>

Confidential Appendix 1 – Report & Financial Modelling by Council Treasury Advisors (LINK)

Confidential Appendix 2 – Council Funding Strategy

<u>Background Papers</u>

Atlantic Wharf Update – July 2023 Cabinet Meeting