Annex A

Capital Strategy 2019/20

Contents

CAPITAL STRATEGY

1.0 Purpose

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential and Treasury Management Codes require, in 2019/20, local authorities to produce a capital strategy to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and take account of stewardship, value for money, prudence, sustainability and affordability.

1.2 The Capital Strategy is a key document for the Council and forms part of the authority's revenue, capital, balance sheet and reserves planning. It provides

- a high level overview of how capital expenditure and capital financing contribute to the provision of services and comments on treasury management activity;
- an overview of how associated risk is managed;
- the implications for future financial sustainability.

1.3 The aim of the capital strategy is to provide an understanding of the Council's overall long-term objectives, governance procedures, allocation and monitoring of capital expenditure and risk appetite.

2.0 Scope

2.1 The Capital Strategy is reported separately from the Treasury Management Strategy Statement; treasury investments will be reported through the Treasury Management Strategy Statement and non-treasury investments will be reported through the Capital Strategy. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the non-treasury function where the policy for service and commercial investments are usually associated with capital expenditure in relation to an asset. This capital strategy sets out the long term decisions on capital expenditure and capital investments and will explain the approach to:

High level overview:

- Service objectives relating to the investments;
- Corporate governance arrangements for non-treasury investment activities;

Overview of how associated risk is managed:

- Risks associated with treasury investments (treasury management investments) and non-treasury investments (commercial investments);

Implications for future financial sustainability:

- Expected income, costs and resulting contribution;
- Debt related to non-treasury investment activity and the associated interest costs;
- Payback period (Minimum Revenue Provision (MRP) policy);
- Other ratio analysis

2.2 The non-treasury investments (see definition below) - due to the expenditure being either for commercial activity or for valid service delivery - do not always give priority to security and liquidity over yield (like treasury investment do). For non-treasury investments, decisions on this type of capital expenditure will either be approved at Cabinet or Council in the Capital programme or in individual reports. Individual

reports will identify risks and the impact on the financial sustainability of these schemes

2.3 All Cabinet reports will ensure that the Council has the appropriate legal powers to undertake such non-treasury investments and will also include the 'proportionality of non-treasury investments' so that the Council does not undertake a level of investing which exposes it to an excessive level of risk compared to its financial resources.

2.4 Monitoring of all investments will be included in the quarterly capital and treasury management monitoring reports which are approved by Cabinet and Council.

2.5 The chief finance officer – Director of Finance (S151 Officer) - will report explicitly on the affordability and risk associated with the capital strategy as detailed below and, where appropriate, will have had access to specialised advice to enable conclusions to be reached.

A high level overview of how capital expenditure and capital financing contribute to the provision of services and comments on treasury management activity

3.0 Definitions

3.1 The definitions in part 3.0 will assist the readers understanding of the Capital Strategy and covers (i) capital expenditure, (ii) treasury management investment (iii) non-treasury management investment, which includes (iv) service investment and commercial investment.

3.2 Capital Expenditure - is incurred on the acquisition or creation of assets, or expenditure that enhances or adds to the life or value of an existing fixed asset that is needed to provide services. Fixed assets are tangible or intangible assets that yield benefits to the Council generally for a period of more than one year, e.g. land, buildings, roads, vehicles. This is in contrast to revenue expenditure which is spending on the day to day running costs of services such as employee costs and supplies and services.

3.3 The 10 year Capital Programme is the authority's plan of capital works for the next ten ~~future~~ years, including details on the funding of the schemes. Included are the projects that relate to 'Service Investment' such as the purchase of land and buildings, the construction of new buildings, design fees and the acquisition of vehicles and major items of equipment. Commercial Investment is also included in the 10 year Capital Programme.

3.4 The definition of 'Service Investment' and 'Commercial Investment' which are both types of non-treasury investments, along with the definition of treasury management investment, is detailed below.

3.5 **Treasury Management investment** – is activity that covers those investments which arise from the organisation's cash flows and debt management activity, and ultimately represent balances which need to be invested until the cash is required for use in the course of business.

3.6 For Treasury Management investments the security and liquidity of funds are placed ahead of the investment return. The management of associated risk is set out in the Treasury Management Strategy Statement and the Annual Investment Strategy.

3.7 The CIPFA Treasury Management Code recognises that organisations may make investments for policy reasons outside of normal treasury management activity. These are non- treasury investments and include service and commercial investments.

3.8 **Non-Treasury Management Investment** – is the expenditure made on the purchase of a capital asset and are investments for policy reasons outside normal treasury management activity. It is these Non-Treasury Management investments which are the subject of this Capital Strategy and can further be described as Service Investments or Commercial Investments

3.9 **Service Investments (Non-Treasury Management Investment) -** These are investments held clearly and explicitly in the course of the provision, and for the purposes of operational services of the Council and projects including economic development schemes, capital expenditure in ICT and etc

3.10 **Commercial investments (Non-Treasury Management Investment)** - These are investments taken mainly for financial reasons. These may include:

- expenditure on investments arising as part of business structures, such as shares and loans in subsidiaries or other outsourcing structures such as IT providers or building services providers;
- expenditure to third parties where the aim is to enhance and support the local area whilst obtaining generated income through interest;
- expenditure explicitly with the aim of generating income for the prudent management of the Council's financial affairs e.g. fixed assets which are held primarily for financial benefit, such as investment properties;
- this list is not exhaustive.

4.0 Council Objectives

4.1 Council Priorities - The Council has agreed four corporate priorities and a number of corporate aims and objectives which guide its work and are set out in the Council Plan. Capital expenditure for non-treasury investment (Service and Commercial) projects must be in line with these overall objectives as well as individual service aims and objectives.

4.2 Other Council Considerations - Capital Schemes must also comply with other Council policies, strategies and plans of the Council, Contract Procedure Rules, Financial Regulations as well as complying with legislation, such as the Disability Discrimination Act. Important linking documents for reference are:

- Council Plan;
- Asset Management Strategy;
- Risk Management Guide
- Individual Service Plans;
- Contract Procedure Rules;
- Financial Regulations;
- Economic Development Strategy
- Treasury Management Strategy Statement and Minimum Revenue Provision Policy.
- Commercial Strategy

4.3 Asset Management Strategy – it is worth highlighting the Asset Management Strategy which is influential in ensuring that capital expenditure contributes to the enhancement and development of the Council's assets to ensure they are used to best effect for the community and to provide services, whilst also considering surplus asset that can be considered for disposal. Future expenditure in new assets – additions to the capital programme – is key for advancement and improvements for all Council objectives as expenditure will be to invest in assets to support services the Council directly delivers however also to invest in commercial opportunities to generate income which will be used to support all Council services in the future.

4.4 The Asset Management Strategy is currently under development and will be reported to Members for approval in the Autumn 2019.

4.5 Performance Management of Capital schemes – In order to ensure that capital expenditure (non-treasury investment – service and commercial) projects are in line with the Council's overall objectives, individual service aims and capital scheme goals clear measurable outcomes should be developed. These objectives should be documented in a Project Initiations Document (PID). After the scheme has been completed, the outcomes should be evaluated to certify that they have been achieved. Post scheme evaluation reviews should be completed by departments for all schemes; those over £50,000 and also strategic capital projects will be reported to Project Management Board. Reviews should look at the effectiveness of the whole project in terms of service delivery outcomes, design and construction, financing etc. and identify good practice and lessons to be learnt in delivering future projects.

5.0 Capital Expenditure Plans and Capital Financing

5.1 Capital Expenditure Plans and the Budget Setting Process – Part of the Capital Strategy importantly notes that consideration is given to the capital budget setting process. This is provided to Cabinet and Full Council on an annual basis proceeding the new financial year in February. In order for the capital programme to be constructed, consideration is given to schemes across the Council by reviewing option appraisals and feasibility studies which contribute to the construction of individual capital schemes initially in the form of a high level overview which is followed by a more detailed Project Initiation Document (PID).

5.2 The capital budget setting processes is designed to ensure the capital programme occurs and contributes to service delivery and commercial investment; this process contains the following items:

- Options Appraisals, Feasibility Studies
- Key Criteria for capital expenditure
- Identifying the need for Capital Expenditure/Investment – Project Initiation Document
- Deciding which schemes are to be put forward
- Prioritisation of schemes put forward
- Member Approval Process
- Monitoring of the Capital Programme Expenditure

5.3 Further detail setting out the capital budget setting process is attached at **Annex A**.

5.4 Budget Setting Process: 10 Year Capital Programme – Capital expenditure for service and commercial non-treasury schemes often occur over many years, depending on the size and complexity of the project. Therefore, estimated payment patterns are calculated for each project so that the expected capital expenditure per year is known. This is called a cash flow projection or budget profiling. The length of the planning period is defined by the financing strategy which is 10 years and also considers the risks faced with reference to the life of the project/assets. For example some schemes may span two or three years (e.g. building an extension to a leisure centre) whereas others may be over much longer timeframes (e.g. Ground Source Heat Pumps or Commercial Portfolio investments). It should also be noted that some scheme will complete within one financial year.

5.5 The approval of a rolling 10 year capital programme assists the Council in a number of ways. It assists service managers, allowing them to develop longer term capital plans for direct service delivery and also corporately for commercial portfolio income generating schemes to support future delivery of services. It allows greater flexibility in planning workloads and more certainty for preparation work for future schemes. It matches the time requirement for scheme planning and implementation since capital schemes have a considerable initial development phase. It will also allow greater integration of the revenue budget and capital programme.

5.6 Value for Money and procurement - Prior to expenditure being incurred on any scheme a Value for Money project appraisal occurs for each project and the annual Capital Programme is approved at Council before the commencement of the new financial year. Procurement is the purchase of goods and services, with a strategy being developed to assist with the definition of quality standards and securing provision of the best possible services for local people for a given price. The Council has a Procurement team that ensures they provide value for money and to see where efficiency savings can be achieved.

5.7 It is essential that all procurement activities comply with EU procurement directives and adhere to the relevant requirements stipulated in directives. Guidance on this can be sought from the Procurement team. Procurement must also comply with the Councils policies and regulations such as Contract Procedural Rules and Financial Regulations. The main aim is to hold 'value for money' as a key goal in all procurement activity to optimise the combination of cost and quality.

5.8 Budget Setting Process: In Year Opportunities - these can be put forward for entry into the capital programme in a managed way either when the capital programme is reviewed each quarter and gets reported to Cabinet and Council or outside of this timetable as a separate Cabinet report to seek approval at any other meeting in the Cabinet cycle. Any other schemes which arise during the year will only be considered for borrowing or funding from central resources if they meet one or more of the following criteria:

- The location of the property to be purchased will bring added value to the estate;
- The requirement for the asset is an extraordinary service demand which could not be anticipated in the normal planning processes;
- There is a limited time span when the opportunity is available.

Requests for approval of revisions to the profiling of scheme expenditure across financial years and the movement of budget between schemes (known as a virement) will be considered by Cabinet at the appropriate quarterly reporting points during the

financial year. These will be at July Cabinet when the capital outturn report is considered, at September Cabinet for quarter 1, December Cabinet when the mid-year review quarter 2 is considered from 30 September and at the February Cabinet meeting when quarter 3 is reported and the new capital bids are considered for the 10 Year Capital Programme for the next financial year.

5.9 Capital Monitoring process - Once the Capital programme has been set it is monitored on a quarterly basis through Project Management Board which is then reported to Cabinet and full Council.

5.10 Capital Financing, Funding Strategy and Capital Policies - This section sets out the policies of the Council in relation to financing capital expenditure and investment and covers the following capital funding:

- External Funding
- Capital Receipts
- Revenue Funding
- Reserves
- Invest to Save Schemes
- Prudential/Unsupported Borrowing
- Leasing

5.11 Further detail setting out the capital funding is attached at **Annex B**.

6.0 Corporate governance arrangements - Non-Treasury Investment activities

6.1 Corporate Governance Arrangement **-** The governance structure of the Council is detailed in the Council's Constitution where all capital decisions are report to Cabinet and Council for approval. Non-treasury investment is expenditure on capital for service improvements or commercial opportunities. This section does not include treasury management investment which is covered in the Treasury Management Strategy Statement.

6.2 The Council's Programme Management Board - takes a corporate and group view on the capital programme and investment, where this group receives information from the operational Asset Management Working Group. Programme Management Board will also ensure a corporate and group portfolio perspective to the use and allocation of the Council's capital assets and in planning capital investment on service capital expenditure; for commercial capital investment see below. The Programme Management Board receives reports on proposed capital projects, as well as monitoring reports for those included in the Capital programme on a regular basis. Post scheme evaluation reviews should be completed by departments for all schemes; those over £50,000 and also strategic capital projects will be reported to Project Management Board. The Programme Management Board is key in finalising the Capital Programme for approval at Cabinet and Council every year prior to the beginning of the financial year.

6.3 Management Team - receives the minutes from Programme Management Board on a monthly basis focusing mainly on service capital schemes and is also instrumental in the decision making and recommendations to Cabinet and Council around capital expenditure for commercial investment opportunities.

6.4 Investment Board - A robust decision making process for making time restricted decisions on service capital expenditure below £5m has been approved by Cabinet and Council to provide this ability to the Chief Executive and Leader. This will occur in conjunction with the Investment Board which currently consists of the Chief Executive, the Deputy Chief Executive, the Finance Director (S.151 Officer) and the Director of Legal and Governance (Monitoring Officer) to provide oversight and will only occur if it not possible to convene Cabinet and service capital expenditure decisions are required in a tight timescale.

6.5 Investment Board and Commercial Activities – the process for making commercial investments has be devised to ensure that appropriate oversight, quality assurance and risk management is in place. In addition to Management Team involvement, this includes the Investment Board (as set out in the Cabinet Report "Commercial Opportunities" on the 9th October 2018). Further development of the role of the Investment Board and potential extension of membership will occur in due course and be taken to cabinet and council. In addition, it should be noted that all commercial investment opportunities and decisions will be brought to Cabinet and Council for approval.

7.0 Corporate Governance arrangements: Guidance from CIPFA Prudential Code and Statutory Investment Guidance

7.1 CIPFA Prudential Code (amended 2017) and Statutory Guidance on Local Government Investments (3rd Edition) (April 2018) in accordance with Local Government Act 2003 has been taken into account when writing the Capital Strategy and considering the corporate governance arrangements under which the Council invests for non-treasury capital expenditure specifically for a commercial purpose.

7.2 The Council has sought legal advice to confirm under which legal powers it is acquiring commercial properties, Counsel's advice on the legal status of the CIPFA guidance and how the capital strategy and non-treasury commercial activity fit with the guidance. This guidance will be available in due course and referred to for non-treasury commercial activities. The Council will use its "power to invest" for the prudent management of the Council's financial affairs.

7.3 CIPFA's Prudential Code and the Statutory guidance on Local Government investments state that Council should not "borrow in advance of need". The intent of the "borrowing in advance of need" within the revised English MHCLG Investment Guidance (paragraph 46 of the Guidance and 35 of the Commentary) relates to the borrowing to fund income generating assets, essentially the commercial agenda. In effect a re-working of the "borrowing to on-lend" argument from the then named Department of Communities and Local Government (DCLG) guidance originally issued on 1 April 2004 and the wide acceptance that this was illegal. The expectation in within this revised wording is that borrowing to invest in purely income generating assets is to be discouraged and not undertaken, and activity should be financed by capital. However, the Guidance goes on to state that if this is disregarded, and funded by borrowing; the rationale is to be set out to elected members. This can be contrasted with the CIPFA Prudential Code paragraph 45, 62 (and E16), which allows borrowing in advance of need against the CFR for the current and next two financial years. These two approaches can be seen as confusing.

7.4 The interpretation of the Code and the Statutory Guidance has varied across organisations. However, a large number of Local Authorities have recently invested in Commercial Property in a bid to generate additional revenue; where some Local Authorities have taken borrowing to do so. This Council will undertake borrowing to support commercial investment with the rationale to Members that due to the reduction in Government Funding it is necessary for the Council to look at all options in order to generate income to support services for the future.

7.5 The increased borrowing by Local Authorities from the Public Works Loan Board (PWLB) to fund property investments and the continued ambiguity around what constitutes "borrowing in advance of need" to invest in commercial property for profit has also prompted CIPFA to release a statement on the 18th Oct 2018 stating that

- "local authorities *must not* borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed."

It further states that

- "CIPFA considers that where the scale of commercial investments including property are not proportionate to the resources of the authority, that this is unlikely to be consistent with the requirements of the Prudential Code and the Treasury Management Code."

7.6 The Council is mindful of the CIPFA prudential Code and does not propose to borrow more than or in advance of need. The rational that the Council intends to borrow is that the capital expenditure for the commercial investment portfolio will be incorporated into the Council's capital programme where the borrowing of the Council will be looked at in it totality within its Capital Financing Requirement and the appropriate Authorised Borrowing Limit will be set. This can be seen in the Treasury Management Strategy Statement that is approved by Council every February prior to the beginning of the new financial year.

7.7 In addition, in relation to commercial investment and proportionality this is described in the 'associated risk' and 'implications for future financial sustainability' sections of this Capital Strategy.

7.8 The Statutory Guidance on Local Government Investments (3rd edition) sets out the expectations in terms of disclosures where a Local Authority chooses to disregard part of the Prudential Code which includes risk management of any potential income shortfall (Paragraph 47).

- "*Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:*

  - *Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and*
  - *The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing."*

7.9 The 'associated risk' and 'implications for future financial sustainability' section of the Capital Strategy addresses these issues. In addition these matters will also be address in a future reports to members on non-treasury commercial activities.

7.10 In addition CIPFA is of the view, as well as is stated in the guidance, that if a local authority invests outside its boundary, using borrowing to support this, in other areas of the UK to generate profit then it may be hard to justify this as it is not for core services to the resident. CIPFA is aware of the requirement for local authorities to support themselves due to reduction in Government funding however if commercial property investments are looked at in isolation then the local authority will be open to scrutiny to justify the borrowing for this this. If reserves where used to fund the commercial property investment then this would be in accordance with the guidance. The reserves of the Council are further addressed in the 'risk associated' and 'implications for future financial sustainability' section of this Capital Strategy.

7.11 The Council believes that in accordance with the Prudential Code and Investment Guidance, that if the capital programme is reviewed as whole and borrowing is for the entirety of the capital programme and property investment is looked at within this then this commercial property capital expenditure investment could be considered as justifiable. For example if property investment occurred in Scotland and the income generated form this support the Business & Economy Section (not a statutory service) then this enables resident to receive a valuable service to help them with their business through 'lunch & learn', conferences, funding opportunities etc. As long as the Council can clarify and confirm its position on prudence then this is in line with the code. (It should be noted that this is not the view of the Council's treasury management advisor Link Asset Services who believe that investment should be maintained within the boundary).

7.12 The Council's view on prudence and its prudent approach to the consideration of its position on the Minimum Revenue Provision is included in the 'implications for future financial sustainability' section of this Capital Strategy - Treasury Management Strategy Statement - Minimum Revenue provision (MRP) Policy Statement.

7.13 The guidance also suggests a range of indicators should be established and reviewed on a regular basis as part of the Capital Strategy; again this is seen in this Capital Strategy in the following two sections - 'risk associated' and 'implications for future financial sustainability'.

An overview of how associated risk is managed

8.0 Associated Risk

8.1 Risk Management Overview - Risk is the threat that an event or action will adversely affect the Council's ability to achieve its objectives and to execute its strategies successfully. Risk management is the process of identifying risks, evaluating their potential consequences and determining the most effective methods of managing them and/or responding to them. It is both a means of minimising the costs and disruption to the organisation caused by undesired events and of ensuring that staff understand and appreciate the element of risk in all their activities.

8.2 The aim of risk management is to reduce the frequency of adverse risk events occurring (where possible), minimise the severity of their consequences if they do occur, or to consider whether risk can be transferred to other parties.

8.3 Risk Appetite and Monitoring - To manage risk effectively, the risks associated with each capital project need to be systematically identified, analysed, influenced and monitored. It is important to identify the appetite for risk by each scheme as well as for the capital programme as a whole.

8.4 The appetite for risk associated with treasury investments (treasury management investments) is centred around the security, liquidity and yield and is covered in the Treasury Management Strategy Statement. For completeness of this Capital Strategy risks associated with treasury investments is attached at **Annex C**

8.5 The appetite for risk associated with capital expenditure on non-treasury investment schemes can be for service investments described above) and commercial investments.

8.6 When the Capital Programme is produced at the beginning of every financial year, the capital budget setting process – as detailed above – includes the requirement for each capital scheme to write a Project Initiation Document. For capital expenditure on Service Investment this Project Initiation Document includes the risks associated with that scheme; these risks are then captured in each of the Department's Section Service Plans, consolidated in the Corporate Risk Register which are monitored on a quarterly basis being reported to Scrutiny Committed and at least annual an update on risk is provided to Audit Governance & standards Committee.

8.7 For those capital schemes which are of a commercial nature, and are capital assets held primarily for financial return, these schemes are significant to the Council and in accordance with transparency a separate cabinet report would be written which would include the associated risks. These risks are then also included in the Corporate Risk Register and would be reported to Scrutiny on a quarterly basis, with at least an annual update to Audit Governance & standards Committee.

8.8 An assessment of risk should therefore be built into every capital project and major risks recorded in the Corporate Risk Register. More information is available in the Risk Management Guide which is approved by Audit Governance and Standards Committee.

8.9 When investing in capital assets held primarily for financial returns, under the CIPFA Prudential Code these are defined as investments and so the key principle of control of risk and optimising returns consistent with the level of risk applies.

8.10 Measures to manage risk - The following measures to manage the risks associated with commercial investment are listed below and the Director of Finance (S151 Officer) will report on the affordability of these risks associated with the capital strategy in the Capital Monitoring and Treasury Management report on a quarterly basis:

(i) Proportionality - Advice from CIPFA is that borrowing for investment should be proportionate to the Council's overall budget.
- a 20% limit is deemed as an appropriate level for the commercial investment finance costs to be set at as a proportion of the budget.

(ii) Reserves Position - The financing cost is deemed to be manageable if income from the investment properties was reduced, due to the Council's balance on reserves being £13.5m at quarter 2 2018/19.

- the Council's 10 Year Financial Strategy 2019/20 to 2028/29 shows that the end of 10 years the reserve position remains at £10m, with the lowest point of reserves being £8m in 2023/24.

(iii) Financial strategy review - It is important to note that a shortfall in net income that is received on the commercial investment will reduce the funding that supports the budget, however it is highly unlikely for the entire net income to be eroded so a smaller proportion of funding would need to be found. The Council's reserves are allocated over 10 years in the financial strategy;

- the 10 year financial strategy would be reviewed along with the budget and reported to Members at the earliest opportunity if there was to be a short fall in income.

(iv) Geographical and Sector Diversity - The commercial investment would be made across several assets in different sectors and geographies to reduce the risks associated with this investment. To ensure a low risk profile it is crucial to invest across the UK and in different sectors. The Council is already in the process of acquiring Treadmills Phase 1 within its administrative boundaries and, as part of a balanced portfolio, the Council would seek opportunities in other areas in the UK, outside the retail sector. Opportunities are likely to be sought in the industrial, warehousing and office sector.

- the geographical and Sector diversity of commercial investments to be monitored

(v) Low risk of income shortfall -v- return - The risk profiles of assets vary greatly and this is reflected in the yield of an asset. The higher the yield of a commercial investment the more income it generates as a proportion of its purchase price, however this is associated with higher risks e.g. voids, maintenance costs, income shortfall and/or failing tenants. It is therefore crucial to acquire assets where a balance is struck between an acceptable return on investments and a low risk of income shortfall.

- Any proposed investment in a commercial asset will include the purchaser's costs associated with any acquisition.
- All commercial assets will be sought to be occupied under full repairing and insuring terms.

(vi) Net Yield - The Council's policies for investment decisions would be set out in an Acquisition Strategy, which would be developed and approved by Council before any further purchases are made to avoid a reactive approach to market opportunities. This would ensure that any investments that are considered are in a strategic context. Within the Strategy an overall net yield between 4.5% and 5.5% should be targeted to balance risks and returns. Advice from property investment advisors shows that most Local Authorities are looking for a yield between 4.5% and 5.5%. The strategy would also consider thresholds and criteria for acquisitions which will provide safeguards to avoid overexposure to one particular location or sector.

- an overall net yield between 4.5% and 5.5% should be targeted to balance risks and returns or an explanation as to why this is not achievable

(vii) Specialist Investment Advice - A property investment advisor should be appointed to act on behalf of the Council. Property investment advisors have established relationships that give them access to off-market opportunities, preferential treatment and the experience to avoid bidding wars; approaches by 'agents' would be motivated by the desire to sell a property and would not

take into consideration whether these properties are a good investment for the Council and therefore should be avoided.

- The investment advisor would help develop and implement an Acquisition Strategy.
- The investment advisor would be expected to produce quarterly reports on the Council's Investment Portfolio, the commercial property market, any management issues emerging as well as any risks.
- The investment advisor could also act as the property manager carrying out any management function (Licence for Alterations, landlord inspections, rent reviews etc). The management cost would be taken into account when establishing the net yield of the portfolio.
- Council will seek advice on the terms required in the tendering of the property investment advisor to ensure strict monitoring for the Council and to be able to hold the advisor to account.
- The Council will seek advice on the terms required in the tendering of the property investment advisor to ensure strict monitoring for the Council and to be able to hold the advisor to account.
- The investment advisor will be held to account by the Investment Board, Management team and an update provided to Cabinet and Council

(viii) Decision Making and the Investment Board - A robust decision making process for making commercial investments has be devised to ensure that appropriate oversight, quality assurance and risk management is in place. This includes the Investment Board (as set out in the Cabinet Report "Commercial Opportunities" on the 9th October 2018). The Investment Board currently consists of the Chief Executive, the Deputy Chief Executive, the Finance Director (S.151 Officer) and the Director of Legal and Governance (Monitoring Officer).

- The role of the Investment Board and its membership will be reviewed and brought back to Cabinet.

8.11 Due Diligence - For all capital investments, Service Investments and Commercial Investments, the appropriate level of due diligence will be undertaken with the extent and depth reflecting the level of additional risk being considered. Due diligence process and procedures will include:

- effective scrutiny of proposed investments by the relevant committee;
- identification of the risk to both the capital sums invested and the returns;
- understanding the extent and nature of any external underwriting of those risks;
- the potential impact on the financial sustainability of the Council if those risks come to fruition;
- identification of the assets being held for security against debt and any prior charges on those assets;
- where necessary further independent and expert advice will be sought.

8.12 Legal and Regulatory Risk - This is the risk that changes in laws or regulation and makes a capital project more expensive or time consuming to complete, make it no longer cost effective or make it illegal or not advisable to complete. Before entering into capital expenditure or making capital investments, the Council will understand the powers under which the investment is made. Forthcoming changes to relevant laws and regulations will be kept under review and factored into any capital bidding and programme monitoring processes.

8.13 The Director of Finance (S151 Officer) will report explicitly on the affordability and management of these risks, listed above, associated with the capital strategy which will be included in the Quarterly Monitoring report - Capital programme and treasury Management strategy - to Cabinet as well as being reported to the Investment Board if required as described above. Where appropriate the Director of Finance (S151 Officer) will have access to specialised advice to support conclusions reached and will also ensure that due diligence is undertaken where appropriate.

8.12 The Director of Finance (S151 Officer) will ensure that Members are adequately informed and understand the risk exposures being taken on.

Implications for future financial sustainability:

9.0 Financial Sustainability

9.1 The capital strategy sets out the long term decisions on capital expenditure and capital investments and ensures that implications for future financial sustainability are transparent.

9.2 The current decisions on capital expenditure and capital investment are considered in the 10 year Capital Programme covering the financial years 2019/20 to 2028/29. The 10 year Capital Programme is set within the fiscal parameters of the Financial Strategy, a key feature of which is to ensure that at the end of the 10 year Strategy sufficient reserve funds – grants, contribution and capital receipts – remain available. The 10 year financial strategy also includes the finance costs associated with the borrowing required to support the capital programme.

9.3 The 10 year capital programme and the 10 year financial strategy ensure that the Council's capital plans are affordable, sustainable and prudent.

9.4 The future capital plans of the Council out to 30 years are to ensure that capital expenditure continues to invest in

- service assets - to maintain the long term fabric and delivery of services in line with Council Objectives to the residents, businesses and communities of Hambleton and
- commercial assets - to support the delivery of services from income generating schemes.

9.5 In order for the Council to ensure future capital plans are financial sustainability the capital strategy indicators are classed into the following four areas and these will be monitored on a quarterly basis in the Capital Programme and Treasury Management Strategy reports to Cabinet and Council:

- Expected income, costs and resulting contribution
- Debt related to the activity and the associated interest costs
- Payback period (Minimum Revenue Provision (MRP) policy)
- Other Ratio analysis

10.0 Expected income, costs and resulting contribution

10.1 The capital plan for non-treasury investment is split between service capital expenditure and commercial capital expenditure.

- Service capital expenditure is on:

(i) the enhancement or creation of assets for the future of the service
(ii) loans to third parties which benefit the local area for economic and housing advancement to support the district.
(iii) the investment in the Joint Venture Company – Central Northallerton development Company Ltd – where the purpose is to regenerate the local area and bring new businesses into the high street of Northallerton as well as developing the former HMP Prison site.

- Commercial capital expenditure is on:
  (i) the proposed development of phase 1 of the Treadmills Site
  (ii) the commercial property portfolio

10.2 Capital programme expected income, costs and resultant contribution - The ratio of finance costs to net revenue streams prudential indicator also included in the Treasury Management Strategy Statement details the expected Income, costs and resultant contribution; it identifies the trend in the cost of capital (borrowing and other long term obligation costs) against the net revenue stream.

%	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Services	0.12%	0.29%	2.87%	4.06%	4.08%
Commercial activities/non-financial investments	0.00%	0.00%	0.00%	70.91%	70.91%
Total	0.12%	0.29%	2.87%	14.39%	14.45%

10.3 This shows the proportion of finance costs in relation to the Council's total net income position; where the finance costs are the interest on borrowing and the minimum revenue provision set aside to repay that borrowing and where the total net income position is the net funding position of the council – Council tax, business rates, grant funding, income generated – and also income received from the loan to the local housing association.

10.4 Loan to the third party expected income, costs and resultant contribution from the local housing association is detailed in the table below:

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Net Revenue Streams	1,138,400	1,138,400	1,478,400	1,478,400	1,478,400
Finance costs	12,668	28,700	268,070	268,070	268,070
Total	**1,125,732**	**1,109,700**	**1,210,330**	**1,210,330**	**1,210,330**

10.5 The table above details the expected income to be generated from the local housing association using current information available on the interest to be received, and interest rates available to calculate the costs of borrowing.

10.6 Commercial investment expected income, costs and resultant contribution – The following table provides an estimate of future income to be received by the council in investing £40m (the proposed development of phase 1 of the Treadmills Site and the commercial property portfolio). It takes into account financing (borrowing at 2.5% over 50 years) and assumes a net yield of 5% of the portfolio where the net yield takes into account all purchaser's and management costs; then the return to the Council following financing is set out in the table below. In reality not the entire £40m would be invested at the same time, but over a longer period when appropriate opportunities become available and the Council successfully bids for these.

	Year 1-5	**Year 6-10**
Annual Net income	2,000,000	2,318,548
Net Initial Yield	**5.00%**	**5.80%**
Annual Financing Cost	-1,402,284	-1,402,284
Net annual return to Council	597,716	916,264
Yield to council	1.49%	2.29%

10.7 The type of acquisitions that the Council would consider, are likely to have 5 yearly rent reviews linked to the Retail Price Index (RPI). The table above is assuming a compound annual increase of 3% which results in the increase of income from year 6. The table is only an indication as the timing of rent reviews, the staggered purchase of properties and varying yields will result in a different income profile, which can only be determined as and when properties become available for purchase. All purchases will be in accordance with the Acquisition Strategy that is due to be developed by spring 2019.

11.0 Debt related to the activity and the associated interest costs

11.1 Debt related to non-treasury investment activity and the associated interest costs – is illustrated using the table from the Treasury Management Strategy Statement which details the capital expenditure, financing costs, net financing need for the year and the related percentage of total net financing need:

Commercial activities / non-financial investments £m	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Capital Expenditure	0	1,912,000	38,088,000	0	0
Financing costs	0	0	53,556	1,379,879	1,379,879
Net financing need for the year	0	1,912,000	38,088,000	0	0
Commercial activities percentage of total net financing need	0%	16.68%	95.22%	0%	0%

11.2 The table above highlights:

- Net financing need for the year - In 2018/19 and 2019/20 it highlights the need for borrowing to occur to support the purchase of the £40 million commercial investment (the proposed development of phase 1 of the Treadmills Site and the commercial property portfolio.
- Finance costs - are lower initially in 2019/20 as the minimum revenue provision (see paragraph 12.0) is not charged until 2020/21 when the whole of the expenditure on the capital investment has occurred.
- Commercial activities net financing need as a percentage of total net financing need – in 2019/20 this is 95.22% which highlights that there is no significant borrowing on the Service Capital Expenditure plans of the Council This is positive as it means that capital receipts and other funding sources are continue to fund the rest of the Council's capital programme.

12.0 Payback period (Minimum Revenue Provision (MRP) Policy Statement)

12.1 The payback period is the length of time over which it is acceptable to the Council to repay debt. Debt occurs from the borrowing taken to support the Council's expenditure on capital projects in the capital programme. Under Local Government Act 2003 guidance is issued on the payback period of borrowing which is called the Minimum Revenue Provision where it is a requirement for Full Council to approve a Minimum Revenue Provision (MRP) Statement in advance of each year. Recently in light of non-treasury activity - commercial investments – this guidance has been updated for 1 April 2018. in the Treasury Management Strategy Statement.

12.2 The Minimum Revenue Provision Statement is included in the Treasury Management Strategy Statement but also in this capital strategy due to its relevance and is detailed below.

12.3 Minimum Revenue provision (MRP) Policy Statement - It is a statutory requirement that the Council reports on the Minimum Revenue Position and explains this policy. The Minimum Revenue Provision Policy describes that the Council is required to pay off an element of the accumulated General Fund capital spend each year, the Capital Financing Requirement (CFR) through a revenue charge known as the Minimum Revenue Provision (MRP). The Council is also allowed to undertake additional voluntary payments if required. This is known as the Voluntary Revenue Provision - VRP.

12.4 This Council in 2019/20 will have a Capital Financing Requirement of £77,665,383 to support the total capital programme and this is the potential amount of borrowing that may be required in 2019/20.

12.5 Ministry of Housing, Communities and Local Government (MHCLG) regulations have been issued which require the Full Council to approve a Minimum Revenue Provision (MRP) Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following Minimum Revenue Provision Statement*:*

12.6 For capital expenditure incurred before 1 April 2008, or which in the future will be Supported Capital Expenditure, the Minimum Revenue Provision policy will be:

- **Based on Capital Financing Requirement** – Minimum Revenue Provision will be based on the Capital Financing Requirement. This option provides for an approximate 4% reduction in the borrowing need (Capital Financing Requirement) each year.

12.7 From 1 April 2008 for all unsupported borrowing (including Private Finance Initiative and finance leases) the Minimum Revenue Provision policy will be*:*

- **Asset Life Method** – Minimum Revenue Provision will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

12.8 Repayments included in annual Private Finance Initiative scheme or finance leases are applied as Minimum Revenue Provision (MRP), though this Council does not expect to have these repayments in 2019/20 or in the foreseeable future.

12.9 The Capital Financing Requirement for the loan to the local Housing Association will be a maximum of £35,000,000 in 2018/19 and future years. The agreement with the local Housing Association states they will make bullet repayments to the Council at years 5, 10, 15, 20 and 25. The bullet repayments made throughout the life of the loan will be set aside by the Council when received to ensure that prudent provision is made for regular repayment. These regular bullet points will be earmarked and used as the Minimum Revenue Provision that the Council needs to make on a regular basis to reduce the Capital Financing Requirement. Therefore, if a total of £35,000,000 is loaned to the local Housing Association by the end of 2018/19, the first time the MRP charge will be made to the revenue account to reduce the level of CFR will be 2020/21 and at regular intervals thereafter.

12.10 The Minimum Revenue Provision for the £40m commercial investment is also worth noting in accordance with the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003 where it suggests that the life of an asset should not be greater than 50 years. Currently, the financial costs have been calculated using an asset life of 50 years and therefore this is likely to be the steer to the Property Investment advisor when undertaking the commercial investment. The guidance does also state that if a local authority deems an asset to have a life greater than 50 years then a professional advisor is required to be appointed by the local authority to support this, however asset life of greater than 50 years is for capital expenditure to enhance the delivery of services rather than the capital expenditure on commercial investment.

12.11 The Minimum Revenue Provision Asset Life Method provides for a prudent provision to reduce the borrowing need over approximately the asset's life. Therefore the minimum revenue provision set aside would be the same every year. This method of minimum revenue provision is usually used when a maturity loan is taken. An alternative calculation for the minimum revenue provision is when an annuity loan is taken and then the annuity method is used. This occurs when the amount of principle and interest together total the same amount each year; therefore in the earlier years there is a lower minimum revenue provision charge. This method is likely to be used for the initial years of the commercial investment; it is similar to a mortgage and can potentially maximise the amount of income generated to support the revenue budget whilst still being a prudent approach to the repayment of debt.

12.12 When advice is taken form the Property Investment advisor to undertake the commercial investment, consideration will be given to the view that a prudent approach to the repayment of debt is not to set aside an amount at all. The rationale behind this is that the borrowing will be held for a specified number of years to cover the capital expenditure of the commercial investment, then when it is decided to realise the property commercial investment the funds will be returned to the Council. The council will then use this to repay the borrowing; clearly it is expected that the property investment will have appreciated in value. Past performance is no

guarantee of future increase in value of a commercial property investment and therefore if this approach were to be taken a Cabinet report would be written to recommend to Council this approach and Members would be able to make a considered decision.

12.13 Finally it should be noted that a further change introduced by the revised Ministry of Housing, Communities and Local Government (MHCLG) Minimum Revenue Provision Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), called voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the 2019/20 budget the voluntary revenue provision must be stated. This Council has never overpaid minimum revenue provision so this does not apply; however it is noted here for future reference if ever needed.

13.0 Other Ratio Analysis

13.1 Proportionality and Reserves Position - A particular aspect of the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance is proportionality, in effect gearing. Proportionality is a difficult concept and is related to the level of investment asset activity, the risks and how much an individual authority can afford to lose. The General Fund Balance or other usable unallocated available reserves provide a base of the total amount that can be put at risk. Below are worst case scenario examples to show the capital and revenue exposure to the Council and the associated potential loss compared to the reserves of the Council and the budget position.

13.2 If £40m is invested in a commercial activity:

- and £8.0m or 20% of this capital is lost then in accordance with the financial strategy over the next 10 year forecast there are sufficient resources to support this. The lowest forecast of reserves is £8.0m in 2023/24.
- the finance costs in relation to the net budget are 15%, (this is calculated based on 2020/21– when it is likely that the commercial investment will have occurred if approved at Cabinet and Council). A proportion of 20% finance cost to net budget is deemed prudent.

13.3 The intent of proportionality within the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance seems to point to what degree the example activity above is reasonable against the available resources. It is a balance of risk and what is deemed to be excessive risk. For this Council with estimated reserves of between £8.0m and £10.5m at the end of the 10 year strategy, expected losses may be politically unpleasant, but could be contained within the available resources.

13.4 Asset Cover for Debt (loan to value cover) - Indebtedness (Capital Financing requirement- CFR) and external debt in relation to commercial assets, compared against the asset valuations may provide some support, for example £10m of debt with assets valued at £12m may suggest asset cover; assets valued at £8m may suggest disproportionate risk. A higher debt/indebtedness of commercial activity compared with its valuation, may prompt consideration of Minimum Revenue Provision or additional Voluntary Revenue Provision to be required.

13.5 At this Council when the commercial investment at £40m proceeds, the Capital Financing requirement is £40m and if it is financed using borrowing then the extremal debt would be £40m. If the council's surplus funds are used to finance £10m of the commercial investment then the external debt would be £30m. In due course when the assets have been purchased the Council will be able to monitor the debt position of this commercial activity against the value. This will enable the Council to judge whether further minimum revenue provision is needed.

13.6 It is worth noting at this stage the estimates provided in this report for the finance costs in relation to the debt to be taken for the commercial activity have been calculated on £40m. This is the worst case scenario so that this will be the highest amount of finance costs to be incurred.

13.7 Valuations against cost – In accordance with the guidance it is necessary to report to Members on valuations against cost. In line with the detail provided above for Asset Cover for debt, when the capital expenditure has been invested in the commercial activity the information will be available to report valuations against cost and at this further explanation will be provided to assist members understanding.

13.8 Service Capital Financing Requirement (CFR) against Service CFR and Non-treasury CFR - may also provide an indicator of the proportion of the Council's non-treasury investment / commercial activities compared to the whole of the Council's capital expenditure. So for example, a Service CFR £6m against a combined Service and Non-Treasury investment CFR of £12m indicates that the proportion of the non-treasury investment is half of the Council's overall CFR. This can be a useful measure as it raises awareness to the amount of capital expenditure invested in non-treasury activity; which is required generate income to support the delivery of council services on an ongoing basis.

13.9 At the Council the table below shows the proportion of the Council's non treasury investment - commercial activities - in relation to the total capital financing requirement:

Proportion of commercial CFR against the Total CFR	**2017/18** **Actual**	**2018/19** **Estimate**	**2019/20** **Estimate**	**2020/21** **Estimate**	**2021/22** **Estimate**
Capital Financing Requirement (CFR)	**0**	**26,200,000**	**37,664,183**	**77,665,383**	**77,665,383**
CFR - Services	**26,200,000**	**9,552,183**	**1,913,200**	**0**	**0**
CFR – Commercial activities	**0**	**1,912,000**	**38,088,000**	**0**	**0**
Total CFR	**26,200,000**	**37,664,183**	**77,665,383**	**77,665,383**	**77,665,383**
Proportion	**0.00%**	**5.08%**	**49.04%**	**49.04%**	**49.04%**

14.0 Other Considerations

14.1 Partnerships and Relationships with other Organisations - wherever possible and subject to the usual risk assessments, services should look to continue to work on a partnership basis and continually look for areas where joint projects can be implemented.

14.2 Fraud, Error and Corruption - financial losses could occur due to errors or fraudulent or corrupt activities. Officers involved in any of the processes around capital expenditure or funding are required to follow the Council's policies and procedures. At the core of the Council is 'our values' and these instil through the organisation principles and appropriate behaviour. This is supported by the Employee Code of Conduct and detailed policies such as Anti-Fraud and Corruption, Anti Money Laundering, Whistle Blowing and Declaration of Interests.

ANNEX A

Capital Expenditure Plans and the Budget Setting Process

The following capital budget setting processes are designed to ensure the Council Capital Expenditure plans follow this process:

i. Key Criteria for capital expenditure
ii. Identifying the need for Capital Expenditure/Investment
iii. Deciding which Schemes are to be put forward
iv. Prioritisation of Schemes put forward
v. Member Approval Process
vi. Options Appraisals, Feasibility Studies and Project Management process
vii. Monitoring of the Capital Programme Expenditure

Key Criteria Set by Members

For any particular budget setting year, the process starts in the Spring of the preceding year with sessions held with the operational Asset Management Working Group to discuss the key criteria by which scheme proposals will be considered. These may include:

- *How does the scheme contribute to the Councils Plan and Targets?*
- *Is this scheme a statutory requirement?*
- *Does the scheme generate any on-going revenue savings?*
- *What are the costs and revenue implications*
- Does the scheme contribute to an improved service provision/ reduction in risks?

Identifying the need for Capital Expenditure/Investment

The need for a capital scheme may be identified by a Service through one or more of the following processes.

- Services annually prepare Service Plans for the improvement of their areas (ensuring that their objectives meet the overall aims and objectives of the Council); these can identify any capital investment needed to meet future service demands. This is a good method to identifying and planning for service's capital requirements;
- Condition Surveys prepared by Design & Maintenance in consultation with Premises Mangers and notified through Asset Management Working Group.
- Economic Development Strategy identifies needs in the local area and reports to the Project Management Board making future capital schemes known;
- Reviews and external Inspections may also identify areas that need capital Investment from Design & Maintenance and Premises Managers
- The need to respond to Government initiatives and new laws and regulations;
- The need to generate a revenue income to contribute to the funding of services.

These capital plans are raised and discussed at Asset Management Working Group and Project Management Board.
Chief Officers and Portfolio Holders must identify their key capital priorities for the relevant service planning period by the end of summer each year.

Deciding which Schemes are to be put forward

Once the list of key capital priorities has been identified, in preparing capital project proposals consideration should been given to the key criteria identified earlier in the year. Additionally, consideration should been given to:

<u>Prudence:</u>

- Recognition of the capacity in the organisation to deliver such a programme;

- Recognition of the knowledge and skills available and whether these are commensurate with the appetite for risk;
- Recognition of the future vision of the authority;
- The approach to commercial activities including ensuring effective due diligence, expert advice and scrutiny, defining the risk appetite and considerations of proportionality in respect of overall resources;
- The approach to treasury management and the management of risk as set out in the Treasury Management Strategy.

Affordability:

- Revenue impact of the proposals on the 10 year financial strategy;
- The borrowing position of the Council, projections of external debt and the use of internal borrowing to support capital expenditure;
- The authorised limit and operational boundary for the following year;
- Whether schemes are profiled to the appropriate financial year.

Sustainability:

- A long-term view of capital expenditure plans, where long term is defined by the financing strategy and 10 year capital programme and consideration is given to risks faced with reference to the life of the project/assets;
- Provision for the repayment of debt over the life of the underlying debt as set out in the Minimum Revenue Provision policy;
- An overview of asset management planning including maintenance requirements and planned disposals.
- All bids are produced in line with the appropriate timetable with consideration for the financial information contained within the bid.
- Project Management Board is briefed and understand the service need and the budget consequences, both revenue and capital, of completing the scheme.
- Possible sources of funding are considered for each of the proposed capital
- Schemes - each project will be considered in terms of revenue funding to cover the operational running costs of the asset and any borrowing repayment costs, and also how the asset will be funded in terms of capital expenditure.
- The proportionality of the proposals as a whole will then be considered in respect of overall resources and longer term sustainability and risk. The Director of Finance (Section 151 Officer) will take an overall view on the prudence, affordability and sustainability of the overall borrowing level if all bids are accepted.
- Project management board will then consider the bids from a corporate priority perspective.

Prioritisation of Schemes put forward

A formalised corporate system for prioritising capital projects has been adopted by the Council. This has resulted in:

- Identifying essential capital investment where needed for the 10 year capital programme;
- Utilising feasibility studies where needed;
- The ability to enter items into the capital programme in a managed way through firstly the annual Capital budget process and secondly when the capital programme is reviewed on a quarterly basis to Cabinet and council;
- Being mindful of the current level of the programme in relation to capacity to deliver, the relevant financing of schemes and any other running costs.

Member Approval Process

- In late summer, service managers and premises managers will list high level requests for capital projects for their Service to Project Management Board. Consideration will be given and funding allocated. More detailed Project Initiation Documents will be drawn up and finalised in late autumn.
- The overall capital programme is then reported to Cabinet which in turn make their recommendations to Council; this occurs in February before the beginning of each financial year.
- If the capital programme were to be scrutinised then Scrutiny committee can request this to occur and state the aspect that they require further information.
- Members approve the overall borrowing limit – Authorise Borrowing Limit - at the budget meeting in February each year as part of the Treasury Management Report. The taking of loans then becomes an operational decision for the Chief Finance Officer who will decide on the basis of the level of reserves and money market position whether borrowing should be met internally from the Capital Reserve/Capital Receipts or whether to enter into external borrowing.
- Once the Council has approved the capital programme, then expenditure can be committed against these approved schemes subject to the normal contract procedure rules and the terms and conditions of funding.
- Whether capital projects are funded from grant, contributions, capital allocations or borrowing, the revenue costs must be able to be met from existing revenue budgets or identified (and underwritten) savings or income streams.
- Following approval by Council, the capital programme expenditure is then monitored on a quarterly basis to Cabinet and council.

Options Appraisal, Feasibility Studies and Project Management Process

- As part of the process of producing a list of potential schemes for the capital programme service managers and premises managers should complete option appraisals to determine the most cost effective and best service delivery options.
- The option appraisals will include the amount of capital expenditure required, the associated ongoing revenue implications and if there are any savings that result or income generating opportunities.
- Some projects may require a feasibility study. As part of any feasibility study an assessment of the maintenance costs per annum averaged over the whole life of the asset should be calculated. As a minimum this will be based on the RICS (Royal Institute of Chartered Surveyors) recommended benchmark figure prevailing at the time.

For major, complex and strategic projects, as part of setting the capital programme for new schemes and additions, the Council's project management documentation process is followed:

Stage One – Project Initiation

- the initial scheme is submitted to Management Team or Project Management Board which identifies the purpose, the proposed position, financial implications, and issues for consideration.

Stage Two – Project Development

- At this stage is the preparation of the Project Initiation Document occurs and is signed off for the direction of travel, noting the project risks and the initial projection of investment required to realise the project;
- The risk register, regular meetings, communications plans, design of the project etc will all be formed

Stage Three – Project Implementation

- The project commences, the procurement process is followed, the main contractors are appointed and the project is underway.
- The progress of the project is monitored on a regular basis in line with the requirements of the scheme

Stage Four – Project Review

- A final evaluation would be undertaken considering whether the project has met its initial objectives and reviewing all lessons learned.
- Further resources to progress any of schemes will need to be approved separately by Cabinet and/or at quarterly reporting to Cabinet and / or as part of the annual review of the capital programme and would be subject to the relevant resources being available

Monitoring of the Capital Programme Expenditure

Once the Capital programme has been set it is monitored on a quarterly basis through Project Management Board which is then reported to Cabinet and full Council.

ANNEX B

External Funding

- Services must seek to maximise external funding wherever possible to support capital schemes. This can be in the form of grants and contributions from outside bodies including central government. However, services must underwrite any cost overruns on externally funded schemes. If services bid for external funding for schemes and say at tender or during construction or procurement, costs exceed the available funding, then services must fund any shortfall from their existing resources (either revenue or capital) or raise the matter at Programme Management Board.
- Prior to submitting bids for grant funding, an assessment of the risk of a contract price increase, associated with market conditions or abnormal building plan demands attached to some grants, must be completed to estimate the likelihood of additional funding being needed. This is carried out between the service manager or premises manager and Design & Maintenance.
- In respect of match funding bids then the relevant service must fully identify the necessary match funding resources from within existing service budgets or raise the matter at Programme Management Board prior to submitting any bid for funding.

Capital Receipts

- A capital receipt is an amount of money received from the sale of an asset. They cannot be spent on revenue items.
- Programme Management Board, along with the Director of Finance (S151 Officer), will review all of the Council's property annually against the aims and objectives the Coucnil Plan and Asset Management Strategy.
- The general policy is that any capital receipts are pooled and used to finance future capital expenditure and investment according to priorities, although they may be used to repay outstanding debt on assets financed from loans, as permitted by the regulations.

Revenue and Reserve Funding

- Services may use their revenue budgets to fund capital expenditure. In addition specific reserves – economic development fund or the computer fund - which are internal funds set up to finance capital expenditure as an alternative to external borrowing can be used
- The Director of the service and the Director of Finance (S151 Officer) along with Project Management Board will take an overview and decide the most appropriate way of funding capital expenditure

Prudential/Unsupported Borrowing

- Local Authorities can set their own borrowing levels based on their capital need and their ability to pay for the borrowing. The levels will be set by using the indicators and factors set out in the Prudential Code. The borrowing costs are not supported by the Government so services need to ensure they can fund the repayment costs. This borrowing may also be referred to as Prudential Borrowing.
- Capital projects that cannot be funded from any other source can be funded from Prudential Borrowing. The costs of borrowing must be affordable and the borrowing repayment and interest charges on the loan must be included in the Council revenue budget; it must also be factored into the medium term financial strategy accordingly.
- The Director of Finance (S151 Officer) will make an assessment of the overall prudence, affordability and sustainability of the total borrowing requested. The impact

of this borrowing will be reported in the Treasury Management Strategy alongside the Prudential Indicators required by CIPFA's Prudential Code for Capital Finance.

- The view of the Director of Finance (S151 Officer) will be fed into the corporate bidding process so that, should the borrowing levels be unaffordable or not prudent, then the schemes will be prioritised against the available funding from borrowing using the corporate prioritisation system.
- The Director of Finance (S151 Officer) will also determine whether the borrowing should be from internal resources such as reserves or whether to enter into external borrowing.

Invest to Save Schemes

- Occasionally projects arise for which services require assistance with meeting the set up costs of projects which may bring long term service delivery improvements and/or cost savings. The initial set up costs may be of a revenue or capital nature. Assistance for these schemes must be considered on an individual basis by the Project Management Board then the Cabinet (at quarterly reporting time) with consideration to the Council's overall priorities and resources.
- For 'invest to save' schemes assistance may be given for initial set up costs, but it is expected that in the longer term these schemes will produce savings and/or additional income that will as a minimum fund any additional operational or borrowing costs. If the additional savings/income does not cover the additional costs incurred, then the service will be required to fund the gap from their existing budgets (i.e. they will underwrite the savings/income).

Leasing

- The Director of Finance (S151 Officer) may enter into finance leasing agreements to fund capital expenditure on behalf of services. However, a full option appraisal and comparison of other funding sources must be made and the Director of Finance (S151 Officer) must be certain that leasing provides the best value for money method of funding the scheme.
- Under the Prudential Code finance leasing agreements are counted against the overall borrowing levels when looking at the prudence of the authority's borrowing.

ANNEX C

An overview of risks associated with treasury investment

Credit Risk
This is the risk that the organisation with which we have invested capital monies becomes insolvent and cannot pay us our investment returns or complete the agreed contract. Accordingly, the Council will ensure that robust due diligence procedures cover all external capital investment. Where possible contingency plans will be identified at the outset and enacted when appropriate.

Liquidity Risk
This is the risk that the timing of any cash inflows from a project will be delayed, for example if other organisations do not make their contributions when agreed. This is also the risk that the cash inflows will be less than expected, for example due to the effects of inflation, interest rates or exchange rates. Our exposure to this risk will be monitored via the revenue and capital budget monitoring processes. Where possible appropriate interventions will 0ccur as early as possible.

Interest Rate Risk
This is the risk that interest rates will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Interest rates will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

Exchange Rate Risk
This is the risk that exchange rates will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Where relevant, exchange rates will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

Inflation Risk
This is the risk that rates of inflation will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Rates of inflation will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.