CAPITAL STRATEGY

& CAPITAL RECEIPTS STRATEGY

Review JANUARY 2019

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1. Introduction

A Capital Strategy is a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

This Strategy is based on principles of the Prudential Code for Capital Finance in Local Authorities (December 2017). The key messages from the Code is, in relation to capital expenditure, the consideration of Prudence, Affordability and Sustainability.

The Capital Strategy therefore is the policy framework document that sets out the principles to be used to guide the allocation of capital investment across all the Council's services and informs decisions on capital spending priorities within the Council's 4-year Capital Plan. In addition as part of the Strategy the Head of Finance reports on the delivery, affordability and risks associated with this Strategy.

Inevitably the full picture of the control system around the Council's wide range of capital expenditure and its funding is reflected in a range of documents, monitoring and management arrangements. A summary of five key aspects of capital activities are shown in the table below

Capital Expenditure	Debt and Borrowing Treasury Management (TM)	Commercial Activity	Other Long-Term Liabilities (e.g PFI schemes)	Knowledge and Skills
•strategic service plans + asset management plans + capital strategy •pipeline process •capitalisation rules •long-term forecasts •basis of estimating future costs and sensitivity to risk	•projections of external debt and internal borrowing •how debt will be repaid •authorised limit and operational boundary •how TM decisions are made and how they are scrutinised	•dependency of budget on commercial activity •policies for approval and scrutiny •on-going management •implications of borrowing	•identification and approval •on-going monitoring	•knowledge and skills available •use of advisers •training plans
Key Documents				
Capital Strategy Asset Management Plan Council Reports	Treasury Management Strategy TM Mid-Year Review TM Outturn Report	Capital Strategy Investment and Regeneration Strategy Capital Budget	Treasury Management Strategy Statement of Accounts	Treasury Management Strategy

Housing Committee Reports Capital Budget Quarterly Budget Monitoring Reports Statement of Accounts	Revenue Budget Medium Term Resource Plan	Revenue Budget Medium Term Resource Plan Statement of Accounts		
Key Committees and Meetings				
Council Housing Committee Capital & Growth Board	Audit Committee Council	Audit Committee Investment and Regeneration Committee	Audit Committee	

Capital investment is technically described as: **Expenditure on the acquisition, creation, or enhancement of 'non-current assets' i.e. items of land, property and plant which have a useful life of more than 1 year.** A fuller definition is attached at Appendix 2. Expenditure outside this definition will be, by definition, revenue expenditure.

Most non-current assets are properties that are used in service delivery. The Council's land, buildings and infrastructure asset base of some 3,700 properties has a Balance Sheet value (as at 31/3/18) of approx. £445 million, of which £115m are Investment Properties. The outstanding borrowing as at 31/12/18 was £285m with £19m of long term liabilities in relation to PFI schemes.

The Capital Strategy is presented to Council as a Policy Framework document, and links with both the Treasury Management Strategy, Medium Term Resource Plan and the Corporate Asset Management Plan which is the key **operational** asset plan covering repairs and maintenance.

In considering the principles, the Council needs a balance between guidance and prescription to allow a flexible approach to be taken but reflective of times of uncertainty. This Strategy focuses on the key policies for the allocation of capital resources to schemes in line with Council priorities and statutory responsibilities.

The management of the Capital Plan is also supported by the Council's approved Financial Regulations.

2. Guiding Principles

2.1 Approach to Borrowing

The Council is able to borrow money on the money market or from the Public Works Loans

Board to fund capital schemes or, on a short term basis, use its own internal resources (i.e. cash flow). However for all capital schemes initially funded from borrowing, the Council will have to fund the principal repayment and interest costs.

The Council is only able to borrow under the guidance contained in the CIPFA Prudential Code whereby, in summary, the Council is required to ensure that all borrowing is both prudent and affordable. All schemes funded from prudential borrowing are approved by full Council, although in some cases approval of induvial schemes within an overall allocation by Council have an alternative approval process (such as Housing Committee and Investment and Regeneration Committee).

The Prudential Code was revised in December 2017 and requires authorities to ensure that decisions for capital expenditure and investment plans are made with sufficient regard to the long run financing implications and potential risks to the authority and include effective due diligence.

The Council's 2019/20 Treasury Management Strategy recognises the potential need to take an additional £129m of borrowing (net of MRP) to support a number of capital projects, potentially increasing the Council's overall debt (excluding PFI liabilities) to be in excess of £423m.

Based on current economic forecasts a borrowing cost of 3% should be assumed for new borrowing in 2019/20.

A summary of the Council's current and projected borrowing position identifying the approved schemes that have/will resulted in the borrowing are listed in Appendix 1. This is a useful summary for Members to understand the assets financed from borrowing.

The Council takes a prudent approach to new borrowing, paying particular regard to the robustness of the business case to include forward predictions of affordability, with the aim that projects should be self-funding (i.e. create a revenue stream so that the cost of borrowing is cost neutral on Council Tax). However the Council has changed its risk appetite in the past two years and is now approving a significant number of projects that are more commercial in nature. All new proposals for a self-funding or invest to save scheme supported by borrowing must have a robust business case that is presented to senior members and officers prior to approval by Council.

Each business case must clearly identify and consider the ongoing revenue implications of:-

- fixed interest and principal repayment costs
- associated income stream
- volatility of the income stream
- the contribution to the general fund or breakeven point
- the sensitivity of the that contribution
- achieve the target return linked to the purpose of the spend
- ensuring asset value exceeds outstanding debt

All of the above need to be considered for the whole life of the asset.

Each business case must clearly identify and consider the ongoing balance sheet implications of:-

- the change in the level of Council debt
- address how changes in asset value will be funded i.e. capital appreciation and impairment and the total of assets funded by borrowing

To ensure all member are fully informed of the risks and rewards associated with borrowing reporting will include:-

- Total debt of the Council
- The underlying assets funded by that debt
- Ongoing revenue costs of principal and interest
- Income Streams associated with that asset
- Implications of changes in asset values or income streams

To support its revenue budget the Council will continue to evaluate any capital investment projects either acting alone or with partners that will produce an ongoing revenue income stream for the Council.

There may be the need for borrowing that has no identifiable future revenue stream, for example, to repair or construct infrastructure assets. Here a broader view can be taken of the value of repairing the asset to the overall economy of the Bay. The cost of such borrowing falls on the tax payer through payments of debt interest on the Council's revenue account and repayment of debt over a specified period of time. There may still be a need for such borrowing but each proposal should be reviewed on a case by case basis with the project evaluation clearly stating how the borrowing is to be afforded. Given the significant ongoing financial challenges facing this Council over the next few years it is likely that such schemes will be an "exception".

2.2 Long Term Capital Liabilities

The Council can also finance capital expenditure by means of a long term PFI contract, whereby the a private sector company will build and then supply an asset (usually) with services as well) back to the Council for a specified number of years. At the end of the contract the asset transfers to the ownership of the council. The value of the asset and the associated liability over the life of the contract to fund that asset is reflected on the Council's balance sheet. As with borrowing, any decisions on agreeing contracts that result in a long term liabilities are made with sufficient regard to the long run financing implications and potential risks to the authority and include effective due diligence.

Council's may also lease in assets for service delivery rather than purchase. Depending on the lease terms, including the length of lease, these assets and the associated liability over the life of the lease to fund that asset is reflected on the Council's balance sheet. Changes in International Financial Accounting Standards (IFRS16) in relation to lease recognition from 2020/21 (with a restated comparative year of 2019/20) may result in more leased in assets and liabilities being reflected on the Council's balance sheet.

2.3 **Grant Allocations**

The Council receives capital grant funding from government and is able to bid for grant funding direct to particular government departments or from other grant awarding bodies. The funding from central government tends to be un-ring fenced and without conditions, however this funding is at a significantly lower level than in the last decade.

The Council now has greater flexibility in allocating capital grant funding which allows the Council to direct funding to local priorities which may not be in line with government allocations which are, to some extent, based on local need. Service intentions of the identified government body awarding the grant should be taken into account in determining allocations.

Any un-ring fenced capital grants received will be reported to Council. The presumption is that the grants will be allocated in line with the service intentions of the identified government body awarding the grant, however Council has the option to reallocate. Once capital grants have been allocated to a specific service, individual schemes within that allocation are subject to each individual scheme being approved by the relevant Director in consultation with the Mayor and Head of Finance.

The Council continues to bid for additional external grant funding but restricts schemes to those which support corporate priorities or statutory service objectives and where it can be proved that the project is sustainable, and requirements for match-funding and future revenue consequences have been considered and approved. All bids are to be agreed with the Executive Lead for Finance and Head of Finance prior to submission. Where external grants are used the grant conditions of linking to the capital grant and future use of the asset need to be adhered to.

2.4 Capital Receipts and Capital Contributions

The Council receives capital receipts and capital contributions from:

- Asset Disposals
- Right to Buy Clawback
- S106 and Community Infrastructure Levy (CIL)
- Repayment of loans for a capital purpose

Asset Disposals

The policy is to pool all receipts from the sale of all assets sold to support the Capital Plan in line with funding the Council's priorities. The current Capital Plan has a capital receipts target to support previously incurred expenditure that has not yet been met. All capital receipts received should be allocated to support this target and not allocated to new schemes, subject to any potential use of capital receipts under the Capital Receipts Strategy (see para 2.4 below) and any loan repayment. An asset disposal will be deemed to occur when the Council transfers the freehold or a long lease (usually over 40 years)

The Council will consider exceptions to this policy where rationalisation of assets used for service delivery is undertaken and in respect of school sites where the Secretary of State has approved the disposal – such exceptions will require Council decision.

The Council will aim to maximise its capital receipts, where possible, by enhancing the land prior to disposal; e.g. by obtaining planning permission or providing a development plan. As appropriate the Council may dispose of assets by tender or by public auction.

The Council can, by approval, transfer or dispose of assets at below market price for service purposes but this is on an exception basis and the full implications of not achieving market value needs to be considered.

Asset Disposals at nil consideration or below market value

In considering asset disposals, the Council will comply with its Asset Management Plan and the need to take into account the policy on Community Asset Transfers where the Council will consider, on a case by case basis, the potential transfer of assets to an alternative provider after a full assessment of the long term (full life) risks and rewards of the transfer, including the achievement of best value including potential market value, linked to the Council's aims and objectives.

The Localism Act 2011 introduced the "Community Right to Bid" and placed a duty upon local authorities in England to maintain a list of assets of community value. Once an asset is “Listed” any disposal will be under the Community Asset Transfer policy or for market value by tender/auction.

Where the Council proposes to dispose of, or grant a long lease, at nil consideration or at a value below market value this is required to be approved by Council. This will also apply where the disposal is for a community or service benefit.

There may be circumstances, such as the transfer of community school assets under the Academies Act, where assets will also be disposed of at nil consideration.

Right-to-Buy Clawback

100% of these receipts are currently used to support the provision of the approved Housing Strategy, although this policy could be reviewed to provide additional resources for projects in other service areas.

S106 contributions and Community Infrastructure Levy (CIL)

S106 monies come from developer contributions through the planning system. Unless there are service specific conditions on the use of the S106, the monies should be used to support existing Council priorities and commitments rather than be allocated to new schemes. Any S106 monies received without a service or scheme specific allocation within the planning agreement will be allocated in line with Council’s capital scheme priorities.

Any monies received for infrastructure from the Community Infrastructure Levy will not be allocated to a specific service but will be allocated under the CIL arrangements (“the Regulation 123 List”) in line with Council’s capital scheme priorities including any specific funding requirements such as the South Devon Highway.

The current policy is to pool all capital contributions to support the Capital Plan in line with funding the Council’s priorities. The current Capital Plan has a capital contributions target to support the approved Plan that has not yet been met. All capital contributions received should, where possible, be allocated to support this target and not allocated to new schemes.

Repayment of loans for a capital purpose

Where the Council provides a loan for a capital purpose this will be approved by full Council and accounted for as capital expenditure. The repayment of a loan by the borrower will be treated as a capital receipt; however any receipts of this nature will be specifically applied to reduce the value of the Council’s outstanding loan.

2.5 Capital Receipts Strategy

DCLG have revised their statutory guidance in relation to the Local Government Act 2003 on the use of capital receipts for the period from April 2016 to March 2019 and subsequently extended in December 2017 to March 2022. This provides Councils with the flexibility to use capital receipts for “the revenue costs of service reform”. This flexibility is subject to a Strategy for the use of capital receipts being approved by full Council. By approving this document Council will be approving this flexibility to be used as appropriate with any use reported to Council as an amendment to the Council’s capital plan.

Potential uses for capital receipts, (subject to the capital receipts being received and Council approval of changes to capital plan), would be to support any implementation costs for the Council’s transformation programme. DCLG within their statutory guidance have included a number of examples of the type of expenditure that would meet the definition of “revenue costs of service reform".

2.6 Revenue & Reserves

The Council is able to use revenue funding and reserves for capital schemes. However, as a result of competing revenue budget pressures and the continued reduction in government support for revenue expenditure, the Council's policy is generally not to budget to use revenue or reserve funds to directly fund capital projects after the feasibility stage.

Once a revenue contribution has been applied to a capital project it cannot be returned to revenue. However the Council would be able, subject to the approval of the Head of Finance, to use prudential borrowing to replace any revenue or reserve funding used or proposed to be used. This will result in a **one off** return of revenue funding to the Council's revenue budget offset by higher MRP and interest costs to fund the prudential borrowing costs in future years.

2.7 Prioritisation and Approval

It is always difficult to make choices between competing priorities within a top tier Council that delivers so many varied services. It is the responsibly of senior officers and members to consider and prioritise the competing demands for capital resources in the context of the limited central government funding now awarded.

The Council maintains and reports on a rolling four year capital plan (including its funding) that is updated and reported to Senior Leadership Team and Members on a quarterly basis. The capital plan will include any capital expenditure approvals by Council in the previous quarter.

The key stages in the Council's prioritisation and approval process are as follows:

1) A service can submit a capital business case for consideration by the Head of Finance and the officer Capital and Growth Board at any stage of a financial year. The capital business case will be linked to that service's needs. A Capital Reserve list is maintained an updated on an annual basis for inclusion in the Capital Strategy.

2) For a specific scheme is to be approved/funded there will be a requirement for a detailed capital business case. The capital business cases are to be initially submitted to both the Head of Finance and the officer Capital and Growth Board prior to wider consultation with the Council's senior leadership team and the Executive.

   If a scheme is to be funded from (previously approved by Council) allocations the scheme will be approved as stated in the approval or, if the approval process not stated, by the Chief Executive in consultation with the Executive Lead for Finance and Head of Finance and progressed when funding confirmed or,

   if new (confirmed) funding is to be used for a scheme to be funded by, say, a specific grant and if the scheme is supported by the Chief Executive, in consultation with the Executive Lead for Finance and Head of Finance, it will be reported to Council.

   If funding has been allocated by Council to a service without individual schemes being identified at the time of approval, (such as a general allocation to schools for "basic need" projects), individual schemes within that allocation are subject to each individual scheme being approved by the Chief Executive in consultation with the Executive Lead for Finance.

3) Proposals for invest to save or self-financing schemes, (usually financed from prudential borrowing), will also require a detailed capital business case. The capital business case are to be initially submitted to the Head of Finance and the officer Capital and Growth Board. If the scheme is supported it will be recommended to Council for approval.

4) Any recommendations for schemes to be approved by Council will be included in the next quarterly Capital Plan Update Report.

5) Other schemes that do not require financial support but include the use of Council assets as a Council contribution to a scheme will also be subject to the Council's approval process.

6) Where there is a proposal to transfer capital resources from a previously approved scheme to a new scheme and there is a change of "policy", the new scheme will be approved by Council.

7) Where specific approval process has been set up and approved by Council e.g. Investment and Regeneration Committee or Housing Committee that process will apply.

2.8 Affordability and Sustainability of Proposals

The Capital Business Case will identify the projected running costs and financing costs of the relevant asset and assessed the affordability of the proposals both for the initial investment and over the life of the asset. In all cases the capital expenditure and any ongoing costs must be sustainable in relation to the Council's medium term financial plans.

For existing assets the Asset Management Plan will identify the projected running costs and financing costs of the asset and assessed the affordability of the asset over its asset life.

Where an asset is directly linked to generating an income or rental stream, such as an Investment Property, the initial Capital Business case (or Council report) will need to consider the future risks to those revenue returns and how these will be mitigated. This may result in the creation of an earmarked reserve for both income volatility and future asset related expenditure.

2.9 Management and Monitoring of Capital Plan

The key objective of the Council's management and monitoring of the Capital Plan is to ensure that all Members have visibility of the capital plan and the approval of individual capital projects to encourage collective responsibility for the capital expenditure on a project and the success of the schemes themselves.

Arrangements to include:-

1) Overview and Scrutiny Board and Council will receive 3 quarterly monitoring report and one outturn report each year.

2) A Capital budget for forthcoming year will be part of each financial year's budget proposals

3) Committees set up for specific purposes to receive update reports

4) A newly established (Nov 2018) officer Capital and Growth Board now reviews the

Council's Capital Plan and the governance arrangements associated with its various projects

5) Senior Leadership Team and the Executive to have responsibility for the oversight and challenge on the delivery of the capital plan including slippage and outcomes.

6) The capital business cases are to be initially submitted to both the Head of Finance and the officer Capital and Growth Board prior to wider consultation with the Council's senior leadership team and the Executive.

2.10 Alternative Funding and Delivery Opportunities

As Council capital funding is reduced the Council will continue to consider other methods of supporting capital expenditure within the Bay, using alternative funding, such as social investment, private sector finance and third sector funding or by other bodies delivering capital schemes instead of the Council.

The Council can use its assets to support schemes or aim to maximise funding from any source possible, such as European or Local Enterprise Partnership funding.

The Council continues to bid for additional external funding and/or work with other bodies to secure capital investment or consider use of its own assets in a development, but restricts schemes to those which support corporate priorities or statutory service objectives and where it can be proved that the project is sustainable, and requirements for match-funding and future revenue consequences have been considered and approved along with an assessment of the opportunity costs of alternative options. All schemes are to be agreed with the Executive Lead for Finance and Head of Finance prior to submission and/or contractual commitment.

2.11 Investment Opportunities – Non Treasury Investments

Linked to its approach to borrowing and the Council's Investment and Regeneration Strategy the Council will consider, if the opportunities arise and there is a "multiple benefit", the purchase of land and property as an investment – to both generate an ongoing income stream or to realise an increased capital value in the future. CIPFA has classified investment properties as a Non Treasury Investment for reporting purposes and included in the Treasury Management Code of Practice.

The Council will continue to review the guidance associated with this activity. In October 2018 CIPFA released a 'Statement on Borrowing in Advance of Need and Investments in Commercial Properties' expressing concerns in relation to the acceleration of the practice of borrowing to invest in commercial properties and in particular the proportionality in relation to an authority's resources.

https://www.cipfa.org/policy-and-guidance/technical-panels-and-boards/treasury-and-capital-management-panel

The risks associated with investment properties and the Council's strategy in mitigating these risks are outlined and described in the Council's Investment and Regeneration Fund Strategy. The Strategy envisages proposals in two categories:

1. Investment opportunities that deliver both a financial return to the Council and a benefit, improvement or development of the area – 'Investment Opportunities,'

2. Regeneration investment opportunities that deliver significant regeneration benefits to the area – 'Regeneration Investment Opportunities.'

https://www.torbay.gov.uk/council/policies/corporate/investment-strategy/
The Council's Treasury Management Strategy Statement also includes references to the monitoring and reporting of the Council's Non Treasury Investments (NTI).

2.12 Asset Disposal Strategy

Purchases of assets by the investment fund are primarily to be retained in the long term. However the benefit of selling the assets will be regularly reviewed by Head of Business Services in consultation with the TDA Head of Estates for potential disposal at which point any outstanding debt will be repaid. The review will need to consider the resulting impact on the Council's revenue budget from the lost income stream and any costs of disposal.

2.13 Loans for Capital Purposes

Loans for a capital purpose can also be approved by full Council subject to a business case and due diligence on the borrower including as appropriate guarantees and bonds to secure the repayment of the loan. The loan value will not exceed the value of the underlying asset at any time and there should be no third parties legal charge on the asset. Interest will be charged on the loan at a market rate, this will include loans to Council subsidiary companies. This will ensure compliance with State Aid regulation.

2.14 Capital expenditure and assets held by wholly owned subsidiary companies

The Council has overall control of these entities and therefore is ultimately responsible for the companies' assets and liabilities. The controls of any subsidiary's activities are controlled by the Council's through 'reserved matters' listed within the memorandum and articles of association of the company. These 'reserved matters' cover capital expenditure and the making of any borrowing. The assets and liabilities of all council companies would be consolidated into the Council's group accounts.

As these capital assets and liabilities are part of the council's overall financial position the Council will report on the total group assets and liabilities and the associated risk and reward.

In relation to the reserve matters on capital expenditure the Council will apply the same process as applied to its own capital expenditure and will monitor and report performance of the capital assets as part of the Council's quarterly capital monitoring arrangements.

2.15 Training and Skills

The Council needs to ensure that all decisions in relation to capital are properly informed.

Linked to the Treasury Management Strategy a list of officers and members and their relevant qualifications and training undertaken will be maintained. Training will be provided as required.

In relation to skills the Head of Finance, Monitoring Officer and Executive Head of Business Services will ensure that the appropriate expertise is always resourced in relation to any financial, legal and asset related due diligence required.

2.16 Treasury Management Links

All capital decisions to be funded by prudential borrowing will directly impact on the Council's Treasury Management activities. The level and timing of the capital expenditure will be reflected in the capital plan once approved and in the strategic cash flow forecasts to plan for the required borrowing. The resulting costs (Interest and MRP) and any income to fund those costs will be included in the standard budget monitoring and budget setting process. Total borrowing will also be monitored by the annual setting of both the Operational and Authorised Limits (for borrowing).

2.17 Balance Sheet Issues

The impact of capital projects and any prudential borrowing used have an impact on the Council's balance sheet.

1) Increase in the value of the Council's non-current assets
2) Increase in the value of Council's long term debtors (if capital loan provided)
3) Increase in the Council's long term borrowing
4) Maturity profile of borrowing and repayment of borrowing
5) Profile of capital loan repayments
6) Increase/decrease in Capital Financing Account (CFA) by new borrowing offset by MRP.
7) Annual depreciation on operational assets
8) Annual revaluation or impairment on operational assets
9) Annual valuations of investment properties
10) Impact on Council's cash flow in delivery stage or on purchase
11) Impact on Council's cash flow at time of borrowing

The value of non-current assets should always exceed the value of the outstanding liabilities. In addition the value of the outstanding liabilities should not exceed, in the medium term, the Capital Financing Requirement (which is the measure of a Council's underlying need to borrow).

3. Head of Finance Statement on Delivery, Affordability and Risk of Capital Strategy

3.1 Background

The current guidance for a council's level of borrowing is the Prudential Code (December 2017) and as "proper practice" must be adhered to. The following extracts from the Code summarise the Code's approach to level of borrowing (self-regulating) and the governance that should apply.

"the local authority shall ensure that all its capital and investment plans are affordable, prudent and sustainable.

'A local authority shall determine and keep under review how much money it can afford to borrow.'

"the level of capital investment that can be supported will, subject to affordability and sustainability, be a matter for local discretion"

3.2 Torbay Council Borrowing Position - Note: PFI transactions have been excluded.

All borrowing	As at 31.12.18	Projected 31.3.21
	£m	£m
External Borrowing	285	423
Interest and repayment of principal costs	15	24

Interest repayment cost as a % of net revenue budget	14%	22%

Investment Fund Purchases only	As at 31/12/18	Projected 31/3/21	10% sensitivity On Asset value and income
	£m	£m	£m
External Borrowing	152	200	
Interest and repayment of principal costs	6	8	
Rental Income from Investment Properties	(9)	(12)	1.2
Estimated Value of underlying assets for prudential borrowing	144	189	(18.9)
Interest and repayment cost as a % of net revenue budget	5%	7%	
Interest and repayment cost net of investment properties as a % of net revenue budget	(3)%	(4)%	

Potential impact of investment market fluctuations

1. Value of rental income on investment properties decreases by 10%. Assuming £200m invested, revenue budget will have a shortfall of £1.2m pa.

2. Value of underlying asset decreases by 10%. Assuming £200m invested, balance sheet value will fall of £18.9m.

3. General economic conditions may affect the both the rental income and asset values such as economic downturn, "Brexit" and the retail environment. Locally tenants may choose not renew leases or re-negotiate a lower rental.

3.3 Summary of the borrowing position

It can be seen that the risk principally lies in the Council's investment portfolio. The remainder of the borrowing is linked to a range of operational assets which are expected to be used in the long term and have a full provision for the full recovery of principal over the asset life. All operational assets are supported by a robust business case and while there is a risk in income returns not being achieved overall these are not significant.

In relation to investment properties these are more sensitive to the market fluctuations identified above. A MRP is applied to repay the borrowing over the estimated asset life (up to the maximum 50 year asset life identified in the MHCLG Statutory Guidance). An Investment Fund reserve is used (funded from rental income) to mitigate against future income volatility on these assets.

Due to the current low borrowing rates the Council has fixed all of its loans and adopted a flat maturity profile, this mitigates the risk of increasing rates in the long term. However the increased borrowing will increase the council's fixed interest and borrowing costs to be in excess of £24m by 2021, which will be an annual charge to the revenue budget. This fixed cost is partially offset by income streams from the assets funded from borrowing.

3.4 Head of Finance Report

Within the Prudential Code It is the responsibility of the Chief Finance Officer to explicitly report on the delivery, affordability and the risks associated with this Strategy.

Delivery

The delivery of the individual schemes on the plan are directly linked to the original approval of the capital project supported by each project having a client officer and an project manager who are responsible for the delivery of the project (appropriate skills, contracting, planning etc.) and the subsequent achievement of the objectives of that project.

Members, via Overview and Scrutiny and Council receive quarterly updates to the capital plan. These updates are driven by the requirement by financial reporting, however in doing so Members can review and challenge the delivery of projects and any changes to both the timing and value of the capital plan.

If subsequent to the capital project being completed there are variations to the income expected to be generated from that asset, these will be reported as a variance in the quarterly revenue budget reporting and if ongoing be included in the following years revenue budget proposals.

The Council's senior leadership team has oversight for the delivery of and challenge to the capital plan.

Affordability

Affordability is critical in applying the capital strategy and approving projects for inclusion in the capital plan. This is mostly demonstrated by a specific report on the project being presented to council for approval supported by a business case identifying the expenditure and funding, appraisal of alternative options and the risks and rewards for the approval of the scheme.

All projects need to have a clear funding source. If external funding such as an external grant is to be used there needs to be a clear funding commitment.

Affordability of each project needs to be clear, not only for the funding of the capital spend, but also to cover any ongoing costs of the operation and funding of that capital spend.

Where borrowing is to be used the affordability is of greater importance and the affordability has to include the interest costs of that borrowing and the provision for the repayment of the borrowing. This repayment is matched to a prudent asset life and any income streams estimated to fund this asset must be sustainable. The "rules" around the governance of this borrowing is outlined in the prudential code (as summarised above).

At no stage should the asset value be lower than the value of outstanding debt unless there is a clear plan to mitigate that shortfall or to sell that asset.

Risks

The risks associated with a significant capital plan and a significant level of borrowing can be mitigated and indeed should be mitigated as “business as usual”. I.e. all capital projects are supported by business plan, have adequate project management and/or project boards, suitable skills for the delivery of the project, tax planning, cash flow, clear operational plan for the use of the asset, use of specific committees, security and due diligence on loans and purchases, use of external advice where appropriate, project contingencies, full tender process and regular and transparent reporting to members.

There are clear links from the capital plan to both the treasury management strategy, prudential indicators, authorised borrowing limits and the revenue budget. These are also subject to review and oversight by members at Audit Committee and Council.

For any new borrowing, and this is a greater risk as the value of borrowing increases, this does increase the councils overall liabilities that will need to be repaid in the future. In addition this increases the Council’s level of fixed interest and repayment costs that it will incur each year. This is currently increasing rapidly and could exceed a borrowing liability of £423m and ongoing fixed costs of approx. £24m per annum by 2021. This is a clear risk that all members need to be aware of.

However this risk for all assets is mitigated by a robust business case and a full MRP that will repay the borrowing costs over a (prudent) asset life. Any variation in expected income is an issue however given the wide range of operational assets and different income streams this is not a significant risk.

As outlined above in the position statement, investment properties are a different type and level of risk. Risk arises from both variations in income streams (tenant non-renewal etc.) and from asset values (impact economic conditions and retail trends etc.). The Council has established a clear strategy, criteria and a governance route for these purchases (Investment and Regeneration Committee and Council) which has included member training, second opinion on asset values, due diligence, site visits, surveys etc.

There are risks (and rewards) associated with the purchase of this type of assets, therefore all members need to have sight of, and understand the risks and rewards inherent in these commercial investments.

Conclusion

The current system of borrowing is still a self-regulatory system which means that responsibility for borrowing decisions, and the level of borrowing incurred by a Council are determined at a local level. In particular elected members have a key role.

“..the responsibility for decision making and ongoing monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators, remains with full Council”. Prudential Code December 2017

The Head of Finance’s personal view is that borrowing decisions result in a long term commitment to fund that borrowing, and that all decision making should be as transparent as possible both all Members and the residents of Torbay.

The pace and level of change in the council’s borrowing is significant. The Council’s position by the end of 2020/21 could be £423m of borrowing, with a £24m ongoing revenue cost and £12m of rental or interest income from Investment Fund activities. Therefore all members need to be fully informed as to all implications of its capital investment decisions, in particular those funded from borrowing.

Summary of Assets funded by Council Borrowing **Appendix 1**

Investment Fund purchases shaded

	Net Debt on Asset	Total Repayment period	Annual Interest and Repayment Cost	Income Steam or saving to cover Debt
	£m (rounded)	years	£m	
DCC Transferred Debt from 1998	19	50	1	
Supported Borrowing – mostly schools and transport spend from 1998 to 2010.	73	50	5	
Sub Total:	**92**		**6**	
Individual Schemes funded or part funded from borrowing (>£1m rounded)				
Beach Chalets	2	10/25		Yes
Brixham Regeneration	4	40		Yes
Car Parks	1	25		No
Haldon pier	2	25		No
Inner harbour pontoons	1	25		Yes
Office Rationalisation	7	25		Yes
Paignton Library	3	40		Yes (Part)
Princess Promenade	2	25		No
South Devon Highway	15	40		No
Street Lighting	1	4		Yes
Toilets	1	25		No
Torquay Town Dock	1	25		Yes
Capital loan – TDA, Kings Ash House	2	25		Yes
Wren Park – Investment	21	50		Yes
Ferndown – Investment	27	50		Yes
Gadeon House – Investment	17	50		Yes
Fugro House – Investment	21	50		Yes
Capital Loan - South Devon College	4	100		Yes
Capital Loan – Care Home	1	25		Yes
Employment Space – White Rock	7	25		Yes
Medway – Investment	32	50		
Sub Total:	**172**		**9**	
Total Borrowing Requirement – as at 1/4/18 (Actual debt £273m)	**264**		**15**	
2018/19 Individual Schemes funded or part funded from borrowing				
Capital Loan – Parkwood Leisure	2	12		Yes
Woodwater House – Investment	10	50		Yes
Twyver House - Investment	13	35		Yes
The Range - Investment	9	35		Yes

Factory Unit Bodmin - Investment	3	35		Yes
Edginswell Business park - Land	3	25/40		Yes
Sub Total:	**40**		**2**	
Total Borrowing Requirement – as at 31/12/18 (Actual debt £285m)	**£304m**		**17**	
Borrowing approved but not (fully) spent as at 31/12/18				
THAT Group Loan	9	10?		Yes
Amazon, Exeter	15	50		Yes
Hotel, Chippenham	7	35		Yes
Old Toll House	1	35		Yes
Investment Fund to £200m	14	50		Yes
Claylands Redevelopment	8	25/40		Yes
Corporate IT	1	10		No
Edginswell Business park - building	4	25/40		Yes
EPIC	2	25		Yes
Major Structural Repairs	1	25		No
Breakwater, Brixham	2	25		No
Oxen Cove Jetty	1	40		Yes
Paignton Harbour Lights	1	25		Yes
South Devon Highway (Remainder)	3	40		No
Town Centre Regeneration (TCR)	14	25		Yes
Harbour View Car Park – TCR	11	35		Yes
Capital Loan – Housing Company	25	25		Yes
Capital Loan – TDA Paignton Units	2	25		Yes
Toilets – Healthmatic contract	1	25		Yes
Sub Total:	**119**		**7**	
Estimated Borrowing Requirement – as at 31/3/21	**423**		**24**	
PFI Schemes – EFW & Schools	*19*			No
Estimated Capital Financing Requirement – as at 31/3/21	***442***			

Note: The **capital financing requirement** is a calculation based on the Council's balance sheet to reflect the Council's underlying need to borrow to finance its capital expenditure. This calculation also includes any other long term financing of its assets such as PFI schemes and finance leases. Actual borrowing may be higher or lower than the capital financing requirement at a point in time, but in the medium term actual council borrowing and asset related liabilities should not exceed this value.

Appendix 2 - Definition of Capital Expenditure

Capital investment is simply described as:

Expenditure on the acquisition, creation or enhancement of "non-current assets" (non-current assets are items of land & property which have a useful life of more than 1 year)

This definition of capital expenditure that the Council has to comply with for the classification and, therefore, the funding of capital expenditure in linked to International Financial Reporting Standards. "Qualifying Capital Expenditure" under s25 of Local Government Act 2003 is defined when:

"The expenditure results in the acquisition, construction or enhancement of fixed assets (tangible and intangible) in accordance with "<u>proper practices</u>""

"<u>Proper Practice</u>" (from 01/04/10) is under International Financial Reporting Standards (IFRS) rules. The relevant standard is IAS16 which has the following definition of capital expenditure:

"Expenses that are <u>directly attributable</u> to bringing an asset to the location and condition necessary for it to be capable of operating in the manner intended by management".

"<u>Directly attributable</u>" i.e. if building a school – costs linked to the actual construction of the building, not temporary accommodation, moving people around etc.

Subsequent Capital Expenditure on an asset is defined as:

"Expenses that make it probable that <u>future economic benefits</u> will flow to the authority and whose cost can be measured reliably" Subject to….. "if the expenditure is to replace a component, the old component must be written out of the balance sheet".

<u>Future economic benefits</u> i.e. it is not necessary for the expenditure to improve the condition of the asset beyond its previously assessed standard of performance – the measurement is against the actual standard of performance at the date of expenditure; e.g. if service potential or asset life is increased.

Appendix Three

CAPITAL PLAN - RESERVE LIST DECEMBER 2018

Capital Scheme	Ref.	Main Funder	Cost to Council £m
Protecting Children			
PARIS replacement - social care case management	100	TC	1.000
Funding for primary school places in Paignton (beyond existing allocations)	101	TC	1.800
Prosperous Torbay			
Town Centres Master plans – (beyond £25m allocation)	200	TC	tbc
Brixham Town Centre redevelopment	201	TC	tbc
Multi Storey Car Parks R&M Backlog	202	TC	3.200
Freshwater Car Park expansion	203	TC	tbc
Riviera Centre - R&M backlog	205	TC	1.000
Healthy Lifestyles			
none	300		
Attractive and Safe Place			
Torre Abbey Mansion Phase Three - match funding	401	EH	1.200
Backlog Transport Infrastructure R&M	402	TC	20.000
Environment Agency Schemes - match funding - various	403	EA	tbc
Backlog Property Assets R&M	404	TC	22.000
Princess & Haldon Piers structural repair	405	TC	4.600
TOR2 Asset buyback at end of contract/future waste solutions	406	TC	tbc
Car Park Fencing replacement	407	TC	0.062
Cockington Court - R&M backlog	408	TC	0.700
Willows Sport Pitches improvements	409	TC	0.500
Princess Theatre Investment	410	AC	1.000
Illumination (Festoon lighting) Replacement - phase 2	411	TC	0.072
Oldway Mansion - Future Use of Asset	412	TC	tbc
Torquay Harbourside, Option 1 (Public Realm)	413	TC	0.350
Torquay Harbourside, Option 2 (Extend Torquay Harbour)	414	TC	4.000
Torquay Harbourside, Option 3 (New Torquay Harbour)	415	TC	7.000
Vulnerable Adults			
Affordable Housing - via Housing Company (beyond £25m allocation)	500	TC	tbc
Extra Care Housing	501	TC	tbc
Note:			

Structural Highways and Integrated Transport schemes as per specific planning documents for both these functions

NEWS PROJECTS TO BE ADDED FOR 2018 UPDATE:

Brixham Harbour Regeneration (N Arm breakwater, Fish Quay expansion & pontoon berths)	600	TC	14.000
Crossways, Paignton - purchase	601	TC	tbc
Upton Place - approved scheme not progressed	602	TC	tbc
Waste Vehicles purchase - post TOR2	603	TC	5.000
Investment in former TOR2 services	604	TC	tbc
Ongoing Investment in IT	605	TC	0.500