

Capital Strategy 2024/2025

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DRAFT FOR CONSULTATION

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1. Introduction

The Council has a range of capital resources at its disposal, which are used to deliver services and to achieve strategic objectives. These resources include land and buildings, such as offices, schools, parks and open spaces, leisure centres and more.

The Council's ability to maintain these assets, in order to ensure and enhance their role in the delivery of services, is crucial to its financial resilience. If assets fall into disrepair, and are no longer able to fulfil their primary purpose, the Council's ability to deliver the associated services is impaired, and it has resources tied up in sub-optimal assets.

Planning and managing the use of the Council's capital resources is, therefore, vital. This includes understanding the role that these assets play in the delivery of services and ensuring that the Authority's asset base remains fit for purpose.

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

The Corporate Asset Management Plan provides information on the sustainability of these assets, and the efficient use of the asset portfolio to provide value for money. This Plan is available on the Council's website.

When incurring capital expenditure there is an element of risk that needs to be managed by the Council. This risk could be:

- the probability of whether an asset will deliver the projected outcomes;
- the accuracy of the forecasted future running costs and income at the time of acquisition;
- whether it is prudent to borrow for this expenditure

Like other authorities, the Council previously purchased property to provide multiple benefits, including an investment return. This investment return has provided an income stream to the revenue budget and helped to offset some of the budget pressures arising from increased demand and reduced funding from central government. The Council, whilst no longer acquiring such assets, manages existing assets which will have different characteristics and risks.

During the past three years HM Treasury have taken actions to prohibit the purchase of investment assets bought primarily for yield. Torbay Council removed any further such purchases ('debt for yield') from its capital plans. In May 2022, the HM Treasury Public Works Loans Board (PWLB) Borrowing guidance was further updated by reinforcing its expectation that councils do not engage in more commercial activity such as the purchase of investment property and avoid activity that is "primarily for yield". The Council has to submit information to HM Treasury on an annual basis to demonstrate compliance with the guidance. The guidance further defines "regeneration" with a list of characteristics of what HM Treasury would regard as a permissible regeneration project. In summary the Council can only undertake regeneration projects to address market failure, acting only when the private sector cannot deliver and the Council is making a change to

the asset by significant investment or significant change. These regulations apply to all types of borrowing (not just from PWLB).

Economic Conditions

During 2023/24 the Council's capital programme experienced further significant increases in costs owing to instability in the contractor market, and to rises in borrowing costs; the impact of these market challenges is likely to continue over the next few years. These changes reduce the financial viability of capital projects, including those being funded by grants, where the grants have not increased to meet the increased costs.

Where it is considered necessary to proceed with a capital project, (say to secure grant funding or to complete a project already started), the Council can allocate additional borrowing to that project; however, the impact of the additional borrowing costs will need to be assessed and funded in future year revenue budgets.

These additional costs do not alter the Capital Strategy, but rather focus attention that compliance with both the Capital Strategy and the Prudential Code is vital to ensure that capital expenditure and investment decisions are "prudent, affordable and sustainable".

Regulation

Authorities are required by regulation to have regard to the Prudential Code for Capital Finance in Local Authorities (2021) when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003. The key message from the Code is, in relation to capital expenditure, the consideration of Prudence, Affordability and Sustainability.

CIPFA's Prudential Code provides a framework for the self-regulation of the authority's capital financing arrangements. It requires local authorities to set limits on the amount they can afford to borrow in the context of wider capital and revenue planning.

A Capital Strategy is part of the Prudential Code requirements and sets out the long-term context in which capital expenditure and investment decisions are made; the strategy must give due consideration to both risk and reward and to the impact of the strategy on the achievement of the authority's priority outcomes.

The Financial Management Code of Practice has been issued by CIPFA 'to provide guidance for good and sustainable financial management in local authorities and will provide assurance that authorities are managing resources effectively'. The Financial Management Code applies to all local authorities and brings together statutory requirements and Codes of Practice into one document.

The Capital Strategy will therefore need to reflect the standards outlined in the CIPFA Financial Management Code of Practice.

Objectives of the Capital Strategy

The Capital Strategy is one of the Council's key documents; it provides a medium/long term plan, consistent with the plans and strategies shown below, to provide a fully integrated and transparent Plan for the Council:

- Corporate Asset Management Plan;
- Medium Term Resource Plan;
- Capital Investment Plan;
- Revenue Budget;
- Treasury Management Strategy;
- Regeneration Fund Strategy

The Capital Strategy is therefore 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. It informs decisions on capital spending priorities within the Council's 4-year Capital Investment Plan. In addition, as part of the Strategy, the Director of Finance, (Chief Finance Officer), reports explicitly on the affordability and risk associated with the Capital 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.

Capital investment is defined 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 one year". Expenditure outside this definition will therefore be classified as revenue expenditure.

Most non-current assets are properties that are used in service delivery. The Council's land, buildings and infrastructure asset base had a Balance Sheet value as at 31/03/23 of approx. £608 million (compared to £600m at 31/03/22), of which £182 million, (compared to £211m as at 31/03/22), are Investment Properties. The outstanding borrowing as at 31/03/23 was £383m, (compared to £389m at 31/03/22), with £27m of long-term liabilities in relation to PFI schemes. The Council repaid several long term loans in November 2023, reducing overall borrowing to £364m (as at 30 November 2023)

The Capital Strategy is presented to Council as a part of the Policy Framework, and links with both the Treasury Management Strategy, Medium Term Resource Plan and the Corporate Asset Management Plan (being 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.

2. Guiding Principles

Approach to Borrowing

The Council is able to borrow money on the money market or from the Public Works Loans Board (PWLB) to fund capital schemes or, on a short-term basis, is able to 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.

All schemes funded from prudential borrowing are approved by Full Council, although in some cases approval of individual schemes within an overall allocation agreed by Council have an alternative delegated approval process.

The Prudential Code requires authorities to ensure that decisions for capital expenditure are made with sufficient regard to the long-term financing implications, and potential risks, to the authority - including effective due diligence.

Due to the high level of existing Council borrowing, and viability and affordability issues across a number of approved capital projects, the Council has renewed its approach to setting a Capital Investment Plan for 2024/25, only detailing the specific stages, (gateways), of individual projects based on the corresponding funding available. Various grants received, or due to be received, by the Council will be held within a 'project pending' list awaiting drawdown subject to robust and realistic business cases. By taking this approach the specified need for future Council borrowing has been significantly reduced with any new borrowing required being closely scrutinised in terms of security of repayment and fit within the Council's overall debt portfolio.

The Council takes a prudent approach to new borrowing, paying particular regard to the robustness of the business case, including forward projections of affordability; the aim is for projects to be self-funding (i.e. create a revenue stream so that the cost of borrowing is cost neutral). Based on current economic forecasts, an interest rate of 4.5% should be assumed for any new borrowing in 2024/25.

Following the changes to PWLB the Council no longer acquires commercial properties using 'debt for yield'; however, the risks around income on the properties previously purchased, and the ongoing cost of the borrowing, will still need to be managed. 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 the Council's Finance Director, (Chief Finance Officer), prior to approval by Full Council.

Each business case, as appropriate, must clearly identify and consider the ongoing revenue implications of:

- fixed interest and principal repayment costs;
- associated income stream(s) and sensitivity analysis;
- volatility of the income stream(s);
- the contribution to the General Fund and breakeven points;
- the sensitivity of that contribution;

- achieving the target return linked to the purpose of the spend;
- ensuring asset value exceeds outstanding debt;
- demonstrating value for money;
- project sustainability;
- exit strategy and costs

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;
- maintenance of asset to ensure sustainable use

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

- total Council debt;
- the underlying assets funded by that debt;
- affordability - 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, (whether the expenditure is either fully-Council, or shared with partners), that will produce an ongoing revenue income stream for the Council, as part of service delivery, or reduces on-going revenue requirements.

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. Such cases must be exceptional in nature as the Council will need to set on-going revenue budget provision for meeting the cost of such borrowing.

Where economic conditions impact the costs of a scheme, and additional borrowing may be deemed necessary for completion of a project, the cost of such borrowing falls on the revenue budget through repayments of debt on the Council's revenue account over a specified period. There may still be a need for such borrowing, but each proposal will be reviewed on a case-by-case basis, with the project re-evaluation clearly stating how the borrowing is to be afforded. Given the ongoing financial challenges facing the Public Sector over the next few years, it is important that such schemes are exceptions.

The Council's Treasury Management Strategy provides further information on the Council's borrowing strategy for the coming financial year which is detailed as **Appendix 1**.

www.torbay.gov.uk/council/policies/finance-policies/treasury-management/

Long Term Capital Liabilities

The Council can also finance capital expenditure by means of a long term Private Finance Initiative (PFI) contract, whereby a private sector company will build and then supply an asset back to the Council for a specified number of years (usually with services as well). 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 Council decisions on agreeing contracts that result in long-term liabilities are made with sufficient regard to the long-term financing implications and potential risks to the authority and include effective due diligence.

Councils may also lease 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 are reflected on the Council's balance sheet. Changes in International Financial Accounting Standards (IFRS16) in relation to lease recognition are planned to be introduced in 2024/25 (with a restated comparative year of 2023/24) and will result in the leased assets and liabilities being reflected on the Council's balance sheet.

Grant Allocations

The Council receives capital grant funding from central government and can bid for grant funding directly to government departments, or from other grant awarding bodies. Such recent awards include Town Deal Funding for Torquay, (£21.3m), Future High Streets Fund for Paignton, (£13.9m), £20m Levelling Up Fund Round 3, £20m Long Term Plan for Towns for Torquay, and a presumptive £20m for the bay through the Levelling Up Partnership.

All significant 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, on occasions, the Council will seek to reallocate funding for certain projects that either (a) can no longer be delivered within the specified timespan of the grant and/or (b) costs of the project differ significantly from the original bid and subsequent grant allocated.

The Council continues to bid for additional external grant funding for schemes 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 any future revenue consequences have been considered and approved. All bids are agreed with the Director of Finance prior to submission. Where external grants are used, the grant conditions (linking the capital grant to the future use of the asset) must be adhered to.

The governance around capital bids and acceptance of capital funding requires:

- (i) that Council Directors ensure all bids submitted for their portfolio are checked for accuracy;
- (ii) that significant decisions made by Officers should each have a formal Record of Decision;
- (iii) that all bids for Government money must be made and submitted in accordance with the Council constitution and relevant Council policies;

- (iv) that the Council's Finance Director signs off any bid that requires the Council to provide match funding and/or might result in on-going spend being incurred by the Council.

Having received formal approval of grant funding awards, the Council will maintain an active list of all such funding in a 'Grant Project Pending' list awaiting formal business cases to be developed, and approved, demonstrating full delivery, and targeted outcomes, from capital investment. The Council's Grant Project Pending list as at January 2024, is detailed in [Appendix 2](#).

Construction and delivery costs of specific projects will only move from the grant pending list to the formal approved Council Capital Investment Programme following Business Case approval which must include a robust analysis of costs and sources of funding available to complete.

3. Capital Receipts and Capital Contributions

The Council receives capital receipts and capital contributions from:

- Asset Disposals
- Right-to-Buy Clawback
- Section 106 agreements and Community Infrastructure Levy (CIL)
- Repayment of loans for a capital purpose

Asset Disposals

Purchases of assets are primarily to be retained in the long term. However, the benefit of selling the assets will be regularly reviewed by the Director of Pride of Place 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 and any impact of operational delivery from the lost income stream and any costs of disposal.

The policy is to pool all receipts from the sale of all assets sold to support the Capital Investment Plan in line with funding the Council's priorities, including the potential sale of any investment properties. The Capital Investment Plan might have a capital receipts target, and all capital receipts received should be allocated to support this target and not allocated to new schemes. An asset disposal will be deemed to occur when the Council transfers the freehold or a long lease (usually for leases over 40 years where the lease term is significant compared to the asset life).

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. A direct sale can be transacted however, such a transaction must be supported by a 'Red Book Valuation' demonstrating that the sale price represents appropriate 'value' for the Council.

Asset Disposals at nil consideration or below market value

In considering asset disposals, the Council will comply with its Asset Management Framework and the need to consider the policy on Community Asset Transfers. 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 Cabinet. This will also apply where the disposal is for a community or service benefit.

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.

Section 106 contributions and Community Infrastructure Levy (CIL)

Section 106 monies are received 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 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 Investment Plan priorities, including any specific funding requirements, with the allocation of the "neighbourhood proportion" made after the funds have been received.

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 loans.

Capital Receipts Strategy

The Department of Levelling Up, Housing and Communities (DLUHC) have continued to revise their statutory guidance in relation to the Local Government Act 2003 on the use of capital receipts for the period to March 2025. 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, and for the Council to submit "*planned use of the flexibility*" to DLUHC in advance of the financial year.

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. DLUHC 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".

The Council has not used this flexibility to date and there is no plan for its use in the 2024/25 revenue budget.

4. Revenue and Reserves

The Council can use revenue funding and reserves for capital schemes. The Council's policy is generally not to use revenue or reserve funds to directly fund capital projects beyond the initial feasibility stage of a project.

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 Director 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 Minimum Revenue Provision, (MRP), and interest costs to fund the prudential borrowing costs in future years.

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 responsibility of senior officers to recommend to Members the prioritisation of competing demands for capital resources in the context of the limited central government funding awarded.

The Council maintains and reports on a rolling four-year capital plan, (including its funding), that is updated and reported to Cabinet, Directors and Members through Overview and Scrutiny on a quarterly basis. The Capital Investment 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 initial consideration to the Director of Finance and the Capital and Growth Board at any stage of a financial year. The capital business case will be linked to that service's needs.
2. For a specific scheme 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 Director of Finance and the Capital and Growth Board prior to wider consideration by Directors and the Cabinet.
3. If a scheme is to be funded from previously approved, (Council), allocations the scheme will progress in accordance with the stated approval process. If new (confirmed) funding is to be used for a scheme, (e.g. a specific grant), it will be reported to Full 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 approval by the relevant Director and subsequently reported into the Capital and Growth Board and to members through the quarterly reporting.

4. 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 is to be initially submitted to the Director of Finance and the Capital and Growth Board. If the scheme is supported, it will be recommended to Council for approval.
5. Any recommendations for new schemes to be approved by Council will be included in the next quarterly Capital Investment Plan Update Report (or Council Budget Monitoring Report).
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.

Affordability and Sustainability of Proposals

The Prudential Code also requires that, in making its capital investment decisions, the Council should have explicit regard to option appraisal and risk, asset management planning, strategic planning for the authority and achievability of the forward plan.

The Capital Business Case will identify the projected running costs and financing costs of the relevant asset and assess 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.

This will include consideration of:

- service objectives, e.g., strategic planning for the authority;
- stewardship of assets, e.g., asset management planning;
- value for money, e.g., option appraisal;
- prudence and sustainability, e.g., risk, implications for debt and whole life costing;
- affordability, e.g., implications for council tax/district rates;
- practicality, e.g., achievability of the forward plan.

Where an asset is directly linked to generating an income or rental stream for service delivery, the initial Capital Business case 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.

Capital Investment Plan 2023/24 to 2026/27

In March 2023, the Council approved a four- year Capital Investment Programme of circa £270m. The foundations of this programme were built up over many years which, having been thoroughly reviewed, have identified the following issues:

- Some projects are represented in terms of funding available as opposed to the cost of actual delivery (which is often substantially more);
- There are several high financial level allocations of funds for specific purposes, (such as housing delivery and economic development), without clarity as to what will actually be delivered and when;
- Some projects have been in the programme for some significant time without clarity regarding deliverability and/or outcomes;
- There is an absence of clear Business Cases and/or Financial Cost Appraisals supporting several projects.

To address this, a new approach is proposed from 2024/25 onwards which significantly scales back the components of spend within the Council's approved Capital Investment Plan. Approved spend for each project will progress work, and development, of the project to the next relevant Gateway at which point there will be a requirement for further Council approval to progress, adapt or cease the respective project.

The level of external grant funding that the Council has attracted over recent months has been significant. Ranging from Town Deal Funding, Future High Streets, Station Funding, Levelling Up Round 3 and the forthcoming Levelling Up Partnership, overall grant funding will exceed over £100m as we progress through 2024/25.

To improve transparency and promote strong governance, all grant funding, linked to the associated projects that they relate to, will be maintained as a separate 'pending' monitoring sheet which will sit outside of the Council's approved Capital Investment Plan. Projects, and associated funding will only move across from the 'Grants Pending List' to the approved Capital programme following the development, and approval, of a fully costed and deliverable Business Case (approved by Council).

The 'Grant Pending (approved Business Case) List', as at January 2024, is detailed as [Appendix 2](#) to this document, with the revised 2023/24 to 2026/27 Capital Investment Plan for the Council detailed in [Appendix 3](#).

Management and Monitoring of Capital Investment Plan

The key objective of the Council's management and monitoring of the Capital Plan is to ensure that all Members and the Council's senior leadership team, have visibility of the Capital Investment 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.

The Council's Director Group will ensure that progress against the programme – in terms of expenditure and timescales – is in line with what has previously been agreed. Where projects are exhibiting cost overruns or delays in the completion schedule, these should be addressed promptly.

Arrangements include:

1. Overview and Scrutiny Board and Cabinet will receive three quarterly monitoring reports and one outturn report each year (this could, on occasions, be integrated within quarterly budget monitoring reports).
2. A Capital Investment Plan (and associated budget) for the forthcoming year will be part of each financial year's budget proposals
3. The Capital and Growth Board regularly reviews the Council's Capital Investment Plan and the governance arrangements associated with its various projects
4. Directors and the Cabinet have responsibility for the oversight and challenge on the delivery of the Capital Investment Plan including slippage and outcomes.
5. Capital business cases are to be submitted to both the Director of Finance and the Capital and Growth Board prior to wider consultation with the Council's senior leadership team and for consideration by the Cabinet and Council (as appropriate).

Alternative Funding and Delivery Opportunities

The Council, as appropriate, 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.

The Council continues to bid for additional external funding and/or work with other bodies to secure capital investment and to consider use of its own assets in a development which supports corporate priorities or statutory service objectives. An assessment of the opportunity costs of alternative options must be considered with any agreement needing approval through the Director of Finance prior to submission and/or contractual commitment.

The Partnership agreement, approved by Council in December 2023, to work with Milligan and Wilmott Dixon will explore all available funding options in order to address viability across a number of Council owned development sites across the Bay.

5. Non-Treasury (Commercial) Investments

Linked to its approach to borrowing, the Council has previously considered, where opportunities arose and there was a "multiple benefit", the purchase of land and property as an investment to generate an ongoing income. As reported above, CIPFA has classified investment properties as a Non-Treasury Investment for reporting purposes and they are included in the Treasury Management Code of Practice. The Council will comply with the DLUHC statutory guidance, and any sector-led commentary and opinions associated with this activity. Consequently, all Council Investment Fund purchases have now ceased following the Government's decision to disallow all PWLB borrowing for authorities with any further plans for such investments.

The original Investment Fund was £235m which comprised loans and commercial property. Over time the value of these assets will change which will be reported in the Treasury Management Mid-Year Report and Outturn reports.

It should be noted that if an investment property is sold, the funds received will be a capital receipt and cannot be taken to the revenue account e.g., to offset the loss of an income stream.

In relation to non-treasury investments the updated 2021 **Prudential Code** is clear in that “*an authority must not borrow to invest primarily for financial return*”

“Councils with existing commercial investments are not required by this Code to sell these investments, however Councils that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual Treasury Management Strategy. These reviews should evaluate whether to address expected borrowing needs by taking new borrowing or repaying investments based on a financial appraisal that takes into account of financial implications and risk reduction benefits”

The Council’s investment properties are diversified over a number of sectors and are expected in 2024/25 to produce a net surplus, after borrowing costs and reserve provision, of over £4m. If any of these assets are sold, the Council will need to fund the revenue shortfall resulting from lost rent receipts going forward through either;

- applying the capital receipt from the asset sale to another project, to either avoid borrowing costs on that project, or to reinvest in a project that generates an income stream to replace the revenue shortfall;
- apply the capital receipt to repay borrowing subject to any early repayment penalties;
- applying the ongoing borrowing costs of the asset now sold to another project, where the income from the new project will be able to cover the borrowing costs

The chosen action will need to be in place ideally from date of sale to avoid any ongoing cost of carry of both the old debt and ongoing revenue shortfall.

6. Loans for Capital Purposes

Loans for a capital purpose can 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 should not exceed the value of the underlying asset 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 ensure compliance with Subsidy Control Regulations.

With the new PWLB guidance, the Council’s ability to issue capital loans will be extremely limited, unless they are to its own subsidiary companies.

Capital spend 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 governance of any subsidiary’s activities are controlled by the Council 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 are 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.

Training and Skills

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

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

The Council's knowledge and skills will be complemented by the use of advisers and agents as required.

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 Investment 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.

Balance Sheet Issues

The impact of capital projects and any prudential borrowing involved, will be seen in the Council's balance sheet through;

- Increase in the value of the Council's non-current assets
- Increase in the value of Council's long-term debtors (if capital loan provided)
- Increase in the Council's long-term borrowing
- Maturity profile of borrowing and repayment of borrowing
- Profile of capital loan repayments
- Increase/decrease in Capital Financing Requirement (CFR) - borrowing offset by MRP.
- Annual depreciation on operational assets
- Annual revaluation of, or impairment on, operational assets
- Annual valuations of investment properties
- Impact on Council's cash flow in delivery stage or on purchase
- Impact on Council's cash flow at time of borrowing

The value of non-current assets should always aim to 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).

7. Director of Finance: Statement on Delivery, Affordability and Risk of Capital Strategy

Background

The current guidance for a Council's level of borrowing is the Prudential Code (December 2021) and as "proper practice" it 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."

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

Torbay Council Borrowing Position

The Council's borrowing position, and costs, are summarised in the table below:

| | 2022/23 actual | 2023/24 forecast | 2024/25 budget | 2025/26 estimate | 2026/27 estimate |
|--|-------------------|---------------------|-------------------|---------------------|---------------------|
| External Borrowing | £385m | £359m | £355m | £349m | £347m |
| Other Debt liabilities (PFI) | £15m | £14m | £13m | £12m | £11m |
| Net Revenue Stream | £122m | £131m | £138m | £143m | £148m |
| Financing costs (£m) | £18m | £19m | £18m | £18m | £18m |
| Proportion of net revenue | 14.8% | 14.5% | 13.0% | 12.6% | 12.2% |
| <i>Financing costs exclude income from Investment Property portfolio which is included within the Net Revenue.</i> | £14m | £14m | £14m | £14m | £14m |
| <i>Percentage of Financing Costs to Net Revenue Stream inc. Investment Property Gross Rental Income</i> | 3.3% | 3.8% | 2.9% | 2.8% | 2.7% |

During the course of 2023/24, the Director of Finance has reviewed the overall long term debt liability of the Council alongside investments and cash balances held. This has resulted in a proportion of long term debt being repaid, (taking advantage of the relatively high interest rates in year), with total debt estimated to reduce to £359m at 31 March 2024.

The Council's Capital Investment Plan has also been thoroughly reviewed, and revised, to ensure future affordability and sustainability. This has significantly reduced our forward looking borrowing requirements with the consideration for any new borrowing coming under much closer scrutiny and governance through robust Business Cases and comprehensive financial appraisals.

Borrowing - Risks for the Council

The Council's risk principally lies in:

- (a) **Commercial Investment portfolio** – where borrowing is financed through rental income from the assets held. As mitigation, an Investment Reserve is maintained to address forecasted fluctuations, (e.g. break periods), however, future economic conditions could result in the level of income generated being less than that needed to fund the debt. Current annual income, covering debt costs, maintenance of assets and revenue contribution is circa £14m per annum. The robustness and sufficiency of the Investment Reserve will be reviewed regularly by the Director of Finance and Cabinet Portfolio Holder for Corporate Services, Finance and Housing;
- (b) **Affordability of Capital Investment Plan** – the Council had an ambitious, four year, Capital Investment Plan of circa £270m which was approved in March 2023 of which circa £90m was planned to be spent in 2023/24. The foundations of this Plan were set several years ago under different economic and construction cost conditions. To mitigate this risk the Plan has been reviewed as part of the budget setting process for 2024/25, being significantly scaled down to reflect affordability and deliverability over the medium term;
- (c) **Maintenance of Council Assets** – whereas annual budgets are set aside for on-going repairs and maintenance of assets held by the Council, the funding for any significant repairs and major investment, (e.g. roof replacement), that might occur in the future is inconsistent across the estate. As mitigation, the Council needs to review, and update, its Strategic Asset Management Plan and Asset Management Strategy to ensure that future funding and / or relevant mitigating action is addressed;
- (d) **Robustness of Business Cases** – the Council will continue to deliver significant capital projects over the coming years, particularly around Town Centre Regeneration and, much needed, local housing development. Such projects will require the Council to consider further borrowing alongside alternative funding opportunities. Long term revenue affordability of any future borrowing must be robustly challenged through appropriate and comprehensive business cases.

Due to historic low borrowing rates, the Council has fixed all its loans and adopted a flat maturity profile, mitigating the risk of increasing rates on this historic debt. Future borrowing will increase the Council's fixed interest and borrowing costs, which will be an annual charge to the revenue budget.

8. Director 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 Capital Investment Plan are directly linked to the original approval of the capital project supported by each project having a client officer and a project manager who are responsible for the delivery of the project.

Members, via Overview and Scrutiny Board and Cabinet, will receive quarterly updates to the Capital Investment 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, cost and intended outcomes from the various projects.

The Council's Directors Team, supported by the Capital and Growth Board, 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 Investment Plan. This is 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 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 prior to committing financial liability for the Council. Affordability of each project needs to be understood, 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 key - and that 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.

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

Affordability of the Council's entire Capital Investment Plan has been thoroughly reviewed and updated as part of the 2024/25 budget setting process adopting a gateway process whereby individual projects will be challenged, regarding deliverability and affordability, at various stages of their progression.

Risks

The risks associated with the Capital Plan with 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 plans, 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 Investment 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 where the cost of borrowing rises, this increases the Council’s 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 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 Minimum Revenue Provision that will repay the borrowing costs over a (prudent) asset life.

As outlined above in the position statement, housing and regeneration 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 of economic conditions and retail trends etc.).

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.

The responsibility for decision making and ongoing monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators, remains with Full Council as specified in the Prudential Code.

Borrowing decisions result in a long-term commitment to fund that borrowing, and as such, all decision making and ongoing reporting should be as transparent as possible to all Members and the residents of Torbay.

The pace and level of change in the Council’s borrowing linked to potential regeneration and housing schemes is still potentially significant. The Council’s capital financing requirement (i.e. its underlying need to borrow) needs to be realistic and kept under regular review by the Director of Finance, Cabinet and Full Council.

Director of Finance (Chief Finance Officer)

January 2024