February 2018

Corporate Capital Strategy (including the Capital Receipts Strategy)

Contents

1 Introduction

The Corporate Capital Strategy 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.

Capital investment is technically described as **"Expenditure on the acquisition, creation, or enhancement of 'long term assets'"**. This is 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 long term 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 current use Balance Sheet value of approx. £375 million.

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. Both documents are available from Council offices and on the Council's Website.

Although this Strategy focuses on the Council's management of its own investment in assets, a wider view of capital investment throughout the Bay by both the public and private sectors will have a major influence on meeting Council aims and objectives.

The Capital Strategy sets out a number of guiding principles. 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 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 individual schemes within an overall allocation by Council have an alternative approval process.

The consultation on the proposed changes to the Prudential Code and the Treasury Management Code closed in the autumn and the outcome is expected to be in place before April 2018. The changes are likely to reflect a requirement for councils to have a higher level of diligence on its capital expenditure including commercial activities such as investment properties.

In addition DCLG are consulting on changes to the prudential framework of capital finance. The changes to the prudential framework (i.e. the local authorities investment code and the minimum revenue provision (MRP) guidance) may have an impact on both the Council's assessment of the financial viability of a project (from changes to the MRP guidance) and on an expectation that borrowing will only be for investments that have "multiple objectives" and make a contribution to the core objectives of the Council.

The Council's revised 2017/18 Treasury Management Strategy recognised the potential need to take an additional £200m of borrowing to support a number of capital projects, potentially increasing the Council's overall debt (excluding PFI liabilities) to be in excess of £437m. Based on current economic forecasts a borrowing cost of 3% - 3.5% should be assumed for new borrowing in 2018/19.

A summary of the Council's current and projected borrowing position identifying the approved schemes that have/will result in 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 to the Council). However the Council has changed its risk appetite in the past year and is now approving a significant number of projects to be funded by borrowing and also a 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 the asset to the overall economy of Torbay. 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 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 unringfenced 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, in particular if future funding allocations could be impacted.

Any unringfenced capital grants received, even if these are allocated with service intentions of the identified government body awarding the grant, will be required to be approved by Council. Consequently once capital grants have been allocated to a specific service by Council, individual schemes within that allocation are subject to each individual scheme being approved by the relevant Director in consultation with the Elected 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 by the Chief Executive in consultation with the Elected Mayor 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.

2.3 Capital Receipts and Capital Contributions

The Council receives capital receipts and capital contributions from:

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

Asset Disposals

The current 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 (£0.9m as at Quarter 2 2017/18) to support the approved Plan 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.

Asset Disposals at nil consideration or below market value

In considering asset disposals, the Council will comply with its Corporate 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 in accordance with the Corporate Asset Management Plan. 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 housing function, 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 (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 accordance with this Capital Strategy.

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. 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 subject to approval by 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.

2.4 Capital Receipts Strategy

The Department for Communities and Local Government (DCLG) revised the 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. (note: now extended after draft Local Government Finance Settlement in December 2017). This now 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 Council. By approving this document Council will be approving this flexibility to be used as deemed appropriate by the Head of Finance 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".

2.5 Revenue and 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**.**

2.6 Prioritisation and Approval

It is always difficult to make choices between competing priorities within a top tier Council that delivers so many varied services. A Capital Reserve List is maintained. It will also be important to ensure sufficient flexibility to take advantage of any funding opportunities that may occur mid-year or fill any gaps where slippage occurs.

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

1. If a specific scheme is to be approved/funded there will be a requirement for a detailed business case to be submitted to the Chief Executive in consultation with the Elected Mayor and Head of Finance:

    If new, confirmed and specific funding is to be used for the scheme and if the scheme is supported by the Chief Executive in consultation with the Elected Mayor and Head of Finance it will be recommended to Council for approval

    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 may be approved by the Chief Executive in consultation with the Elected Mayor and Head of Finance.

2. Proposals for invest to save or self-financing schemes, (usually financed from prudential borrowing), will also require a detailed business case to be submitted to the Chief Executive in consultation with the Elected Mayor and Head of Finance. If the scheme is supported it will be recommended to Council for approval.

3. Once new schemes are approved, the Capital Plan will be updated and progress will be reported in the ongoing Capital Plan Monitoring Reports.

4. 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.

5. 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.

6. Where an alternative specific approval process has been set up and approved by Council (e.g. Investment Committee) that process will apply.

2.7 Management and Monitoring of Capital Plan

Arrangements to include:-

1. Ahead of any consideration by the Council, Capital Scheme business cases will be presented to the Chief Executive (who may seek advice from the Senior Leadership Team). In accordance with this Strategy, the Chief Executive will consult the Mayor who may seek the views of his Executive (either informally through the Mayor's Executive Group or formally through the Policy Development and Decision Group)

2. Senior Leadership Team will have responsibility for the oversight and challenge on the delivery of the Capital Plan including slippage and outcomes, reporting issues by exception to the Elected Mayor at meetings of the Policy Development and Decision Groups.

3. Overview and Scrutiny Board and Council will receive regular monitoring reports and one outturn report each year.

4. Committees set up for specific purposes will receive regular update reports

5. Overview and Scrutiny Board and Council will receive the proposed Capital Plan for the forthcoming year.

2.8 Alternative Funding and Delivery Opportunities

As Council capital funding is reduced the Council will continue to consider alternative methods of supporting capital expenditure within Torbay, 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 works with other bodies to secure capital investment or consider use of its own assets in a development. It 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 considered by the Chief Executive (in consultation with the Elected Mayor and Head of Finance) prior to agreement (as per this Strategy and the Council's Constitution) and/or contractual commitment.

2.9 Investment Properties

Linked to its approach to borrowing and the Council's Investment Fund Strategy, the Council will consider, if the opportunities arise, 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. In the consideration of these purchases the Council will consider the DCLG investment principles of "security, liquidity and yield" as applicable.

Purchases of assets through the Investment Fund are primarily to be retained in the short term and reviewed as part of an ongoing annual asset management strategy. However, where a full provision for the repayment of the borrowing (MRP) is not made, there is a then an expectation that these assets will be disposed of in line with the approved business case to repay any outstanding debt. The Council therefore would need to plan for both the disposal of these assets and the resulting impact on the Council's revenue budget from the lost income stream and any costs on disposal.

2.10 Loans for Capital Purposes

Loans for a capital purpose may also be approved by Council subject to an appropriate business case and due diligence 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 party 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.

2.11 Capital Expenditure and Assets held by wholly owned Subsidiary Companies

The Council has overall control of a number of wholly owned subsidiary companies and therefore is ultimately responsible for those companies' assets and liabilities. Activities of these subsidiaries 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.

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 capital monitoring arrangements.

2.12 Transparency and Openness

The Council will try to meet DCLG expectations that Councils are better at explaining the "why" and not just the "what" for their investment activity, and apply transparency and openness to all decisions and reporting on capital expenditure.

2.13 Capacity, Skills and Culture

The Council will try to meet DCLG expectations that, for all officers, members and other individuals involved in the decision making process for commercial investments, disclosure is made of the knowledge and expertise these key individuals.

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 (2013). The following extracts from the Code summarise the Code's approach to level of borrowing (self regulating) and the governance that should apply.

> Key objectives of the Code are to ensure, within a clear framework, that local authorities' **capital investment plans are affordable, prudent and sustainable**.
>
> Local Government Act 2003: '**A local authority shall determine and keep under review how much money it can afford to borrow**.'
>
> Under the prudential system, **individual authorities are responsible for deciding the level of their affordable borrowing**, having regard to CIPFA's Code, which has been given legislative backing. **The system is designed to encourage authorities that need and can afford to undertake capital investment to do so.**
>
> **The prudential system is based on principles rather than prescription. This places the responsibility for the success of the system on the professional judgement of practitioners themselves.**
>
> The introduction of the Code reflects a move towards more self-regulation for local authorities and hence effective corporate governance is one of the key elements to successful implementation of the Code..... **local authorities need to ensure that they have effective governance processes in place and that there is a sense of ownership within the authority.**
>
> It is therefore important that this decision-making process for setting the authority's prudential indicators is able to identify and evaluate risks, while also including **arrangements to reduce such risks to an acceptable level.**
>
> The Chief Finance Officer is responsible for determining and presenting possible capital investment options to members and offering them professional advice. **<u>However, it is the duty of elected members to balance the constraints of affordability with the demands of services for capital investment, and in all but most exceptional cases it will be for elected members to make the necessary judgement.</u>**

It should be noted that CIPFA are currently revising both the Treasury Management Code of Practice and the Prudential Code and DCLG are also consulting on changes to the prudential framework for capital finance. This report has included relevant element of the consultations however this report may need to be updated once the documents have been issued as "final". The proposed changes are also likely to have an impact on the Treasury Management Strategy (which includes the Investment Strategy) and MRP Policy for 2018/19.

3.2 Torbay Council Position Statement

All borrowing	As at 1.4.17	As at 31.10.17	Projected 31.3.20	10% sensitivity on income
	£m	£m	£m	£m
External Borrowing	153	223	436	
Interest and repayment of principal costs	10.0	12.7	21.5	
Income related to borrowing	(1.9)	(8.1)	(16.3)	1.6
Estimated Value of underlying assets for prudential borrowing	67.0	132.4	337.8	
Interest repayment cost as a % of net revenue budget	9%	12%	20%	
Interest repayment cost net of investment income (including investment properties) as a % of net revenue budget	7%	6%	9%	

Note: Private Finance Initiative transactions have been excluded from this table.

Investment Fund Purchases only	As at 1.4.17	As at 31.10.17	Projected 31.3.20	10% sensitivity On Asset value and income
	£m	£m	£m	£m
External Borrowing	21	86	200	
Interest and repayment of principal costs	0.8	3.4	7.4	
Rental Income from Investment Properties	(1.3)	(5.5)	(11.2)	1.1
Estimated Value of underlying assets for prudential borrowing	20.2	81.6	188.6	(18.9)
Interest repayment cost as a % of net revenue budget	1%	3%	7%	
Interest repayment cost net of investment properties as a % of net revenue budget	(1)%	(2)%	(3)%	

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 £1.1m pa.

2. Value of underlying asset decreases by 10%. Assuming £200m invested, balance sheet value will fall of £18.9m. In the scenario where the outstanding borrowing exceeds the asset value, that shortfall will impact on the revenue budget via a higher MRP charge e.g. an £18.9m impairment would have a £1.9m pa effect on the revenue account if shortfall recovered over 10 years.

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 position statement

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 the properties within the Investment Portfolio, these are more sensitive to the market fluctuations identified above. Where there is an assumption that these assets are only held in short term prior to sale therefore a full provision for the full recovery of principal of the asset life may not be applied. To mitigate, a contribution to the capital funding reserve is applied but this does not cover the full value of the loan.

This has two key implications: if an asset is subsequently deemed to be held in the long term a full Minimum Revenue Provision (MRP) will be required which is an increased cost to the revenue account. Conversely when the asset is sold this will result in an income stream being lost from revenue and new sources of income will need to be found. However the loan will be cleared and there may be a one off gain or loss on disposal. The Council will need to include these scenarios in its medium term resource planning and asset disposal strategy.

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 £21 million per annum by 2020, 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 The Delivery, Affordability and the Risks associated with the Strategy

Within the (draft) 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 scheme supported by each project having a client officer and an project manager who are responsible for the delivery of the project and the subsequent achievement of the objectives of that project.

Members, at meetings of both the Overview and Scrutiny Board and the Council, receive regular updates to the Capital Plan. These updates are driven by the requirement of 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 scheme 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, will be included in the following year's 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 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.

Any new borrowing increases the Council's overall liabilities that will need to be repaid in the future. This is a greater risk as the value of borrowing increases. 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 £437 million and ongoing fixed costs of over £21 million per annum by 2020. This is a clear risk that all members need to be aware of.

However this risk for all (non-Investment Fund) schemes 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 which has included member training, second opinion on asset values, due diligence, site visits, surveys etc.

Investment properties can have a full MRP (calculated on an annuity bass) applied. How ever in some circumstances a partial MRP/capital funding reserve contribution may be made on these properties that aim to strike a sensible balance between being prudent and short term investment returns. In these cases although the repayment of purchase costs is being funded over 10 years, the full repayment of the borrowing does rely on the future disposal of the asset to clear the outstanding borrowing. There are risks (and rewards) associated with the purchase of this type of asset, therefore all members need to have sight of, and understand the risks and rewards inherent in these commercial investments.

Concept of Proportionality

As a direct result of Councils' increasing commercial activities funded from borrowing, the DCLG are now referring to the "concept of proportionality" and the resulting "level of debt and aggregate risk being proportionate to the size of the authority".

As a guide, pending the results of the current DCLG consultations, indicators of proportionality for the Council could be.

Measure	Position as at 31/10/17	Potential Position
Contribution Investment Properties make to core functions	Net estimated surplus for 18/19 for only purchases to date is £1.9m which is 1.7% of net budget.	If £200m invested surplus could rise to £4m which is 3.6% of net budget.
Contribution Investment Properties make to core functions	Estimated rental income for 18/19 for only purchases to date is £5.5m which is 5.0% of net budget.	If £200m invested rental income could rise to £11m which is 10.0% of net budget.
Total Borrowing related to Investment properties	As at 31/10/17 £88m which is 38% of total borrowing of £223m	If £200m invested that would be 46% of the projected borrowing total of £437m
Total Borrowing related to "long term assets"	As at 31/10/17 £223m total borrowing is 59% of total long term assets as at 31/3/17 of £375m	If borrowing rises to £437m with a corresponding increase in the value of long term assets then borrowing will be 66% of long term assets.
Total Borrowing costs as a percent of net budget	As at 31/10/17 borrowing costs of £223m are £13m which is 12% of net budget	If borrowing rises to £437m borrowing costs are £21.5m which is 20% of net budget.

3.5 Conclusion

The current system of borrowing is a self-regulatory system which means that responsibility for borrowing decisions, and the level of borrowing incurred, by a Council is determined on a local level. Therefore Elected Members have a key role.

However, it is the duty of elected members to balance the constraints of affordability with the demands of services for capital investment, and in all but most exceptional cases it will be for elected members to make the necessary judgement.

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

The pace and level of change in the Council's borrowing is significant, up to £437 million of borrowing, a £21 million ongoing revenue cost and £12 million of asset related income (mostly rental income). Therefore all members need to be fully informed as to all implications of its capital investment decisions, in particular those funded from borrowing.

Appendix 1 - Summary of Assets funded by Council Borrowing (as at 31/10/17)

	Net Debt on Asset	Repayment period	Annual Interest and Repayment Cost	Income Steam or saving to cover Debt
	£m		£m	
DCC Transferred Debt from 1998	19.3	50	1.3	
Supported Borrowing – mostly schools and transport spend from 1998 to 2010.	73.4	50	4.5	
Sub Total:	**92.7**		**5.8**	
Individual Schemes funded or part funded from borrowing				
Fleet vehicles	0.2	7		No
Beach Chalets – Meadfoot	1.9	25		Yes
Beach Chalets – other	0.4	10		Yes
Brixham Regeneration	4.3	40		Yes
Car Parks	1.0	25		No
Car Parking meters	0.3	10		Yes
Freshwater Cliff	0.4	40		No
Haldon pier	1.5	25		No
Illuminations	0.2	10		No
Inner harbour pontoons	0.8	25		Yes
Office Rationalisation	6.8	25		Yes
Paignton Library	3.1	40		Yes (Part)
Princess Promenade	1.7	25		No
South Devon Highway	14.7	40		No
Street Lighting	1.3	4		Yes
Toilets	0.5	25		No
Torquay Town Dock	0.8	25		Yes
Velo park, Paignton	0.4	40		Yes
Capital loan – TDA	1.5	25		Yes

Wren Park – Investment	21.1	40/100		Yes
Sub Total:	**62.9**		**4.2**	
Total Borrowing Requirement – as at 1/4/17 (Actual debt £153m)	**155.6**		**10.0**	
2017/18 Individual Schemes funded or part funded from borrowing				
Ferndown – Investment	27.4	40/100		Yes
Gadeon House – Investment	16.9	40/100		Yes
Fugro House – Investment	20.4	40/100		Yes
Capital Loan - South Devon College	4.0	25		Yes
Sub Total:	**68.7**		**2.7**	
Total Borrowing Requirement – as at 31/10/17 (Actual debt £223m)	**224.3**		**12.7**	
Borrowing approved but not spent as at 31/10/17				
Capital Loan – Care Home	1.0	25		Yes
Investment Fund to £200m	113.2	40/100		Yes
CCTV replacement	0.4	10		No
Claylands Redevelopment	7.5	25/40		Yes
Corporate IT	1.0	10		No
Edginswell Business park	6.6	25/40		Yes
Employment Space – White Rock	6.6	25		Yes
EPIC	2.0	25		Yes
Major Structural Repairs	2.6	25		No
Oxen Cove Jetty	1.5	40		Yes
Paignton Harbour Lights	0.5	25		Yes
South Devon Highway (Remainder)	2.8	40		No
Town Centre Regeneration	25.0	25		Yes
Upton Place	14.2	25		Yes
Fleet vehicles (remainder)	0.1	7		No
Capital Loan – Housing Company	25.0	25		Yes
Capital Loan – Parkwood Leisure	1.7	12		Yes

Capital Loan – TDA (remainder)	0.6	25		Yes
Capital Loan – Torquay Academy	0.3	7		Yes
Sub Total:	**212.6**		**8.8**	
Estimated Borrowing Requirement – as at 31/3/20	**436.9**		**21.5**	
PFI Schemes – EFW & Schools	*19.6*			No
Estimated Capital Financing Requirement – as at 31/3/20	***456.5***			

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 and 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 "proper practices""

"Proper Practice" (from 1 April 2010) is under International Financial Reporting Standards (IFRS) rules. The relevant standard is IAS16 which has the following definition of capital expenditure:

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

"Directly attributable" means that, for examples, if building a school, it is the 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 future economic benefits 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".

Future economic benefits means that 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.