

CAPITAL FINANCING STRATEGY 2021/22



INTRODUCTION AND CONTEXT

This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas. It is a requirement of the amendments implemented in the 2017/18 Treasury Management Code of Practice Guidance that all Local Authority's will need to produce a Capital Strategy each year.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

The strategy will provide an overarching policy framework for the Council's capital programme and planning, and will form part of a suite of strategies which provide a holistic view of the Council's financial planning framework. With this in mind this document should be considered in conjunction with the Medium-Term Financial Strategy, Treasury Management Strategy and Investment Strategy.

CAPITAL FRAMEWORK

The Council approved the Plymouth Plan in 2015 which sets out the strategic direction for the city.

The Plan identifies specific strategic outcomes for the Council and its partners for the medium and longer-term; these outcomes align to those set in the Plymouth and South West Devon Joint Local Plan.

Performance is measured towards the delivery of the agreed outcomes and reported against on an annual basis.

In February 2020 the Council approved a budget which contained an uplift to the revenue budget of £1.771m to meet the increased costs associated with borrowing requirements to fund the capital programme. The current MTFP contains proposals to further increase this sum by £1.485m in 2021/22, £1.648m in 2022/23 and £1.199m in 2023/24. The MTFP sets out a summary of schemes that the Council wishes to support and an indicative level of Council financial support which will assist in the delivery of those schemes which all deliver towards the city's outcomes.

GOVERNANCE

The Financial Regulations detail how capital projects are approved and added into the capital programme.

All new schemes must be fully financed and receive relevant approval by Section 151 Officer; up to £0.200m, or by the Leader when above this threshold.

Each scheme will need to detail:

- the aim of the project and any other ways of achieving it
- effects on staffing
- legal, contractual and prudential borrowing code implications

- if the Council is acting through an agent or partnership, legal advice must be sought on whether it has the power to act this way
- if it is a key decision, any comments made during consultation and the Council's response
- the estimated amount and timing of any capital and revenue spending.

All proposed new schemes will need to demonstrate how they meet the requirements of the City by presenting a Business Case for approval and detail which of the City's outcomes are being achieved and how the scheme will address this need.

Due diligence is carried out on all new proposals to determine whether the scheme is deemed suitable. Financial and capital planning reviews are carried out prior to any Business Case being presented to the City Council Investment Board to provide members with the confidence that the schemes meet the expected requirements in line with the strategic direction of the city.

Once accepted, all new schemes, which will require both finance and legal sign-offs, are published in the Executive Decision along with the Leaders decision.

CAPITAL BUDGET

The Capital Budget is the collective term which defines two key elements; the Capital Programme as approved by the Leader or S151 Officer and Future Income Assumptions which refer to the funding available for future projects yet to be approved.

The Capital Programme is the list of schemes which have a confirmed financing source and have been approved for capital investment by the Leader following consideration of a robust, evidence-based business case.

"Income Assumptions" is the term used to refer to funding that the Council expects to receive or allocate to finance schemes which have not yet been approved. Income Assumptions consist of both ringfenced and unringfenced resources.

Ringfenced resources are essentially those that can only be applied to a specific purpose and include specific grants and S106 contributions etc. Unringfenced resources can be applied to any project and include unringfenced grants and corporate borrowing etc.

CAPITAL PROGRAMME

Once approved, schemes are added to the capital programme for delivery.

The table below details the Capital Programme as reported to Cabinet in November 2020, including, amongst others, the following schemes:

- Derriford Transport Scheme
- Forder Valley Link Road
- Northern and Eastern Corridor Improvements
- The Box
- Plymouth Railway Station Regeneration
- Oceansgate
- Asset Investment Fund
- Bereavement Infrastructure
- Schools Basic Need

Any adverse variance to approved schemes are required to seek further approval, with identified funding, to enable authorisation for increased expenditure providing details of the variance.

Capital Programme by Directorate

Directorate	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£m	£m	£m	£m	£m	£m
People	6.837	1.882	7.009	3.025	0.000	18.753
Place	130.998	112.341	78.848	10.705	2.676	335.568
Customer and Corporate Services	7.932	30.618	0.000	0.000	0.000	38.550
Public Health	5.209	7.804	0.000	0.000	0.000	13.013
Total	150.976	152.645	85.857	13.730	2.676	405.884

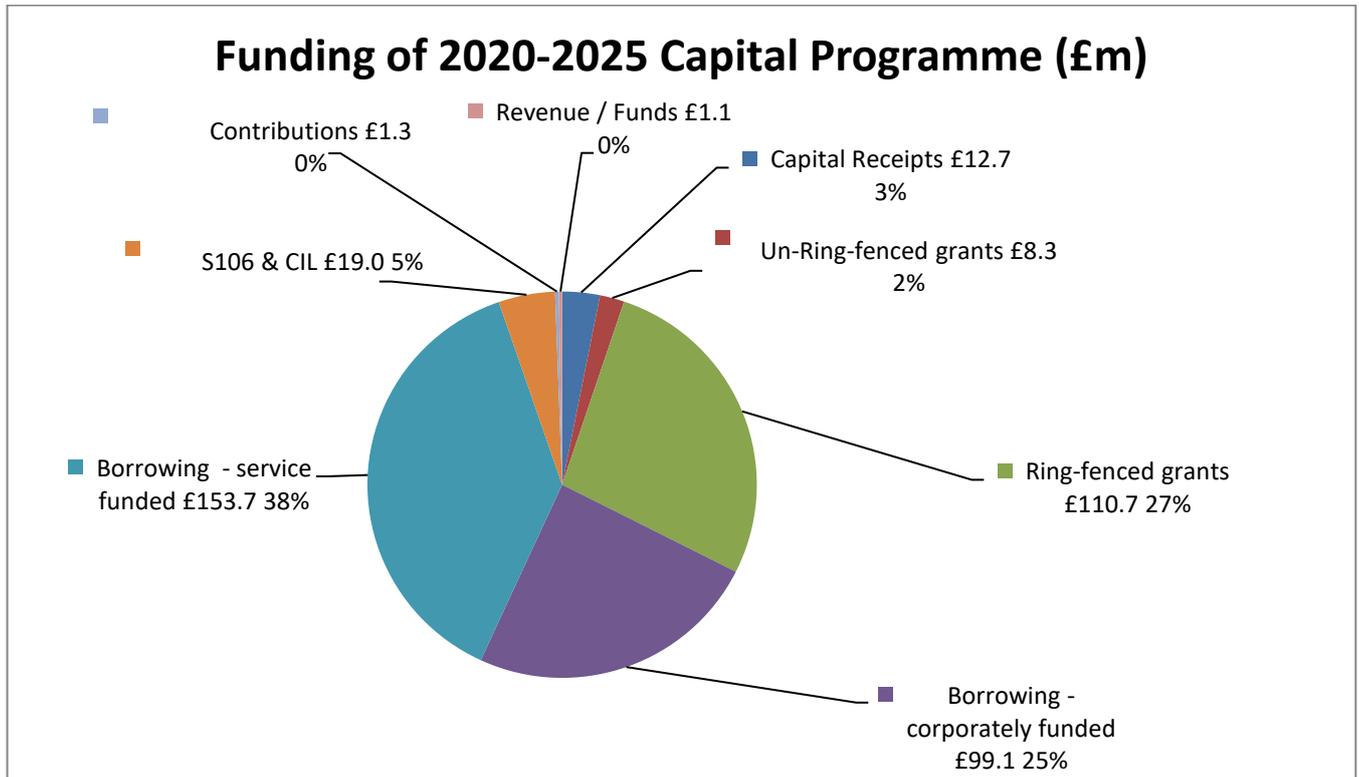
CAPITAL EXPENDITURE AND FINANCING

Capital expenditure is defined as money spent on assets, such as property or vehicles, which will provide a service benefit for more than one year. In local government, this also includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 (land and buildings) and £5,000 (vehicles, plant or equipment) are not capitalised and are charged to revenue in year.

Capital expenditure is financed by a range of sources which may either be ringfenced or unringfenced. The source of financing is always identified and approved at the time of capital project approval. The capital programme is currently financed by:

- Capital Receipts;
- Grants and contributions;
- S106 and Community Infrastructure Levy (CIL);
- Revenue Contribution to Capital Outlay (RCCO);
- Borrowing – both funded corporately, or where schemes deliver a saving, this is offset against the project and repaid by service.

The Council has approved medium-term capital expenditure of £405.884m as summarised below by funding source.



ASSET INVESTMENT FUND (AIF)

The Asset Investment Fund's strategic objectives are to deliver regeneration, economic and employment growth in Plymouth and the Functional Economic Area (Local Economic Partnerships; Cornwall and the Isles of Scilly and Heart of the South West). The council will manage its commercial property portfolio seeking to maintain a ration of no more than 20% of its holdings within the wider area and minimum of 80% being within the city council boundaries.

This will enable the Council to invest in direct developments and forward funding opportunities to promote regeneration and economic growth in Plymouth and the Functional Economic Area.

A robust and well-defined investment strategy is used to manage risk and a key pillar of this is establishing a diversified portfolio with regards to property sector (retail, office, industrial etc.), tenant type and income-expiry profile. Diversification is considered best practice by fund managers to help to minimise portfolio risk and avoid portfolio return volatility (due to different correlations of investment types with exogenous factors). A diversified income-expiry profile will ensure that the funds income return is robust across a number of scenarios.

All investment decisions will be fully accountable and follow a sequence of internal reporting and sign-offs. In addition, verification of purchase prices by external suitably qualified RICS Approved Valuers is obtained prior to any investment.

In terms of on-going governance arrangements, the AIF is managed in accordance with the existing quality assurance framework of the Council's existing commercial property portfolio. In addition, the team undertake regular analysis at both a portfolio and property-level to benchmark AIF performance and manage risk. Bespoke industry-accepted property fund management software is used to assist in this monitoring. To improve transparency and disclosure, a monthly fund managers' report is produced and an AIF Management Group of key stakeholders meet quarterly to review the investments and the performance.

The Asset Investment Fund has approved investment of £238 million in commercial property including direct development and forward funding commercial property schemes to deliver:

- Stimulation of economic and employment growth and regeneration in the City.
- Long-term income generation (via rental revenues) to support the wider financial position of the Council.

The Asset Investment Fund has a well-defined investment strategy to manage risk. A key pillar of this is establishing a diversified portfolio with regards to property sector (retail, office and industrial), tenant type and income-expiry profile. The investment approach is also to primarily target secure investments, which generate a net initial yield in excess of 5% per annum (before debt servicing). The Fund supports the affordability of the revenue budget through the generation of long term income realisation.

The adoption of an Asset Investment Framework provides a sound basis and evaluation criteria on which future property investment acquisitions can be assessed and the performance of the existing investments monitored. This will ensure that the Council's commercial estate will provide a secure long term income stream to help front line service delivery and support the economic development of the City.

AFFORDABILITY

The Council considers all finances from a prudent perspective; this includes the assessment of affordability of all capital investments.

At the point of approval of a scheme, both the funding implications and any ongoing revenue implications are evaluated to enable informed decisions to be made regarding investment opportunities.

Project managers responsible for capital schemes requiring in excess of £0.500m will generally be expected to present a cost benefit analysis to support decision making.

The short, medium and longer-term impacts are all assessed taking into account any other wider policy implications which could impact on the decision.

As much of the capital programme is funded by borrowing, assumptions and decisions on the cost and affordability of the Council's borrowing is linked to the Public Works Loan Board (PWLB) interest rates, prudential indicators and the approved borrowing strategy as set out in the Treasury Management Strategy 2021/22.

RISK MANAGEMENT

The Council considers its appetite to risk to be low. Risks are assessed continually from both an operational and financial perspective.

In carrying out due diligence, potential project risks are identified and relevant mitigation measures documented prior to approval.

All risks are then managed in line with the Council's risk management policy which includes documenting risks on a risk register, assigning owners, regular review of risks and Red Amber Green (RAG) rating.

Subject to careful consideration, the Council may consider investing in a higher risk initiative should there be a significant direct gain to the Council's resources or enable more effective delivery of statutory duties.

KNOWLEDGE AND SKILLS

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Service Director of Finance is a qualified accountant with over 20 years' experience.

The Council pays for staff to study towards relevant professional qualifications including CIPFA, ACCA, CIMA, MRICS, CIPS etc.

Where Council staff does not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.