

BRIEFING REPORT: CAPITAL PROGRAMME FINANCIAL RISK MANAGEMENT



1. Introduction

- 1.1 Plymouth City Council has a significant capital investment programme, reflecting its ambitions to develop and grow the city, and the Council's responsibility for a wide range of assets and statutory services. This report provides the Audit and Governance Committee with an overview of how the financial risks associated with the council's capital programme are managed. Committee are invited to note the arrangements for managing financial risk and the areas of review currently in progress and consider any comments or recommendations they wish to make.
- 1.2 The main areas of financial risk associated with operating a significant and complex capital programme can be characterised as follows:
- *The risk of cost overruns, inflation and market volatility.*
 - *The risk of funding shortfalls.*
 - *A risk that investment does not deliver value for money over its whole life.*
 - *Financial risks associated with safety and regulatory compliance.*
 - *Risks associated with the financing of capital investment.*
 - *The risk that overall levels of capital investment are not affordable.*
 - *Risks associated with financial governance and oversight.*

At Plymouth, the first four areas of risk set out above are principally managed within individual projects and risk management approaches are explained in section 2 below. The final three areas of risk are managed corporately and are covered in section 3 below.

- 1.3 The council's project and programme management arrangements are in the process of being reviewed as part of wider learning following the Armada Way Independent Learning Review (AWILR). This review is anticipated to lead to a strengthening of the council's corporate project management framework and the introduction of a more consistent approach to project assurance and reporting, which will strengthen the management of financial risks in this area. This work will include a review of the Capital Programme Handbook which formalised governance arrangements for all capital programmes.

2. Management of financial risks at project level

Risk of cost overruns & inflation

- 2.1 Capital investment projects are not routine in nature and estimating the cost of many capital projects is inherently challenging in the early stages of a project lifecycle. Plymouth City Council's capital programme includes a number of regeneration and maintenance projects investing in historic assets, brownfield sites or ageing infrastructure - where risk of cost overruns is more significant due to the difficulty of assessing underlying asset condition in pre-construction phases. Cost inflation in the construction sector has been a significant issue in the post-covid period with demand for materials and labour exceeding available supply and driving up cost in international, national or local markets.

- 2.2 These risks are managed at individual project level through the use of professional cost estimation skills at an early stage in the project lifecycle and the inclusion of contingencies in project budgets. On larger schemes, project gateways are built in to ensure that cost and inflation risks are reviewed at key points prior to entering into financial commitments (for example, the use of RIBA stage gateways). The use of professional advisors ensures that estimates of inflation and knowledge of local market conditions are built into initial estimates and reviewed at key phases of the project lifecycle; the council employs skilled project managers and programme leads to ensure that external advisors are co-ordinated effectively, and that financial risks are reported and mitigated on an ongoing basis.
- 2.3 A proportionate approach is taken for smaller capital projects which – in the council's highways and facilities management functions – are delivered through ongoing maintenance programmes. This programme approach allows cost and inflation risks to be managed at programme level, with the size and scope of a programme being adjusted within a financial period to ensure that, overall, costs do not exceed available budgets.
- 2.4 The council's decision making and financial management procedures act as a secondary control framework by setting limits on expenditure at project or programme level, and by ensuring that all project proposals are subject to scrutiny by senior managers, finance and procurement professionals, with appropriate cost parameters established.

Risk of funding shortfalls

- 2.5 A large proportion of the Council's capital programme is funded through external government grants and contributions, which are often subject to time constraints and / or are conditional on the delivery of specific outputs. These externally funded capital projects carry an additional risk of funding being unavailable if conditions are not met. The council employs officers with skills and experience in bidding for and managing external grants, and larger external funding streams are managed through the oversight and control of these experts. Relationships with key funders have been built up over many years and the City Council has a strong reputation for delivering successfully across a range of ambitious outputs.
- 2.6 All capital projects – whether grant funded or not – are subject to the council's procedures relating to the governance of the capital programme. This ensures that the financial risks of accepting capital grants are understood at project inception stage, where the Capital Programme Officer Group ('CPOG') is able to scrutinise grant funding conditions and assess risks, and the capability of project teams to deliver conditions and mitigate the risk of funding clawback.

Ensuring investments deliver Value for Money across the life of an asset

- 2.7 Identifying long term customer / end user benefits, lifecycle costs and building performance at project inception stage is important in ensuring that capital investment delivers value for money in the longer term. Client leadership or sponsorship of project teams (which is the default approach for most significant projects at Plymouth City Council) ensures that the customer / end user perspective is paramount in the design stage of projects. Early involvement of asset management / maintenance departments (e.g. facilities management for buildings, street services teams for public realm assets) at project inception and design stage is an area for improvement currently being addressed through the expansion of the Capital Programme Officer Group to include facilities management expertise.

- 2.8 Formal 'Lessons Learned' reviews for more significant projects aim to capture and disseminate learning following project completion and handover and provide an important opportunity to reflect on how capital investment is delivering against original project objectives. The Capital Programme Officer Group receives post-completion lessons learned reports from major projects; though there is a need to ensure that these are carried out consistently for all major schemes, and also to ensure learning is disseminated effectively across the council.

Health and safety and regulatory compliance risks

- 2.9 Construction projects carry high health and safety risks, and many capital schemes have to comply with a wide range of complex building safety, planning and environmental regulations. The cost consequences of non-compliance can be significant – in extreme cases, projects could require significant and costly re-work during construction if compliance is not carefully designed in at an early stage. The use of professional advisors and architect / design firms (sourced externally, but overseen and co-ordinated by experience client-side construction project managers) ensures that building safety requirements, fire strategies and environmental and planning regulations are understood early in the project lifecycle. Plymouth City Council's project management staff ensure that client health and safety responsibilities required under the Construction (Design and Management) regulations are understood and discharged effectively.

3. Management of financial risk at organisational level

Risks associated with the financing of capital investment

- 3.1 Where capital investment is financed through council borrowing (rather than external grants or contributions), the council is exposed to interest rate and refinancing risks that are managed in line with our Treasury Management strategy. The Audit and Governance Committee (along with the Cabinet and the City Council) receives regular reports on the Council's performance against Prudential Code indicators, and the council's borrowing strategy is developed through an internal Treasury Management Board with the support of expert external advisors. Financial risk management in this area is detailed extensively in other reports to the Committee and so is not covered in detail here.

The affordability of the capital programme

- 3.2 Plymouth City Council has a long track record of ambitious investment – successfully delivering a large range of projects that, collectively, have played a key role in the recent development of the City. Historic capital investment in projects such as the Box, the Life Centre, the Park Crematorium, Foulson Park and many other schemes has been financed, in part, by council borrowing through loans. This historic programme of investment is being continued through the current capital programme which is investing in the City's transport and public realm infrastructure, in new service delivery assets, and in the regeneration of the City. The cumulative financing requirement for historic, ongoing and planned investment presents a financial risk to the Council – it is important to ensure that repayment and interest costs are maintained at an affordable level within the wider revenue budget.
- 3.3 The cumulative outstanding financing requirement for all historic and current capital investment is measured through the Capital Financing Requirement (CFR) – the CFR represents the council's underlying need to borrow, and its calculation is defined by CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code). Benchmarking a council's ratio of Capital

Financing Requirement to 'Core Spending Power' (CSP - a standard measure of total financial resources) is a standard tool, used in the local government sector as a measure of financial resilience and exposure to debt financing costs. A further measure used to evaluate the overall affordability of capital investment is the statutory Prudential Code indicator measuring the council's financing costs as a proportion of its core revenue resources; regularly reported in Plymouth City Council's budget monitoring reports within regular reporting against Prudential Code indicators.

- 3.4 Both of these measures are problematic when used in comparative benchmarking analysis – a high-level comparison of ratios and percentages can mask local factors; robust like-for-like analysis is difficult to achieve, and comparisons can therefore be misleading. For Plymouth City Council, the Capital Financing Requirement and associated financing costs are augmented by historic borrowing for invest-to-save projects (see paragraph 3.7 below). Nonetheless, these measures are widely used within the local government finance sector to assess the affordability of council borrowing.
- 3.5 Notwithstanding the difficulties of robust comparative analysis, Plymouth's CFR:CSP ratio, and an adjusted local indicator measuring underlying 'corporate borrowing' financing costs as a proportion of the councils net revenue resources, indicate that Plymouth has a relatively higher level of financing costs when compared to similar local authorities. This is a reflection of the City Council's historic and ongoing ambitions to invest in the development of public infrastructure, as a vehicle for the regeneration and economic development of the City. Whilst borrowing costs remain within Prudential Code limits and are affordable, it will be important to ensure that this remains the case in years to come.
- 3.6 Council officers are currently undertaking a review of the capital programme for consideration by Cabinet members during the current budget round, to ensure that capital financing costs remains affordable, and the 5-year capital programme strikes an appropriate balance between ambition and financial resilience. The results of this review will be published as part of the Council's Capital Strategy, a statutory document published as part of the suite of budget setting papers for consideration by the City Council at the February budget setting meeting, following a review by the Audit and Governance Committee.
- 3.7 Plymouth City Council has a strong track record of 'invest to save' capital investment in regeneration schemes through the Property Regeneration Fund, and also through targeted interventions to avoid costs, reduce revenue expenditure or generate income in service areas. This is managed through a portfolio of 'Service Borrowing', which carries a separate financial risk – it is important to ensure that the revenue streams and cost reductions associated with invest-to-save projects are sustainable and well managed, and that financial risks are well managed across the duration of loan repayment periods. This separate area of risk is managed through independent scrutiny of business cases (by the finance team and at the Capital Programme Officer Group) at project inception stage, through the ongoing governance of the Property Regeneration Portfolio, and through regular budget monitoring of revenue streams supporting service borrowing. Again, this area is being reviewed through the development of the 2026-27 Capital Strategy, which will be brought to this Committee at its January meeting.

Financial governance and oversight

- 3.8 Effective governance and oversight of capital investment projects – at programme and project level – is important to ensure that the council does not suffer financial loss through poor decision making, fraud or mis-allocation of resources. This represents a final, overarching area of financial risk associated with the capital investment programme.
- 3.9 All capital expenditure is undertaken in accordance with the Council's Financial Regulations and Contract Standing Orders, subject to internal and external audit and the control frameworks established in the Council's Anti-Fraud, Bribery and Corruption policy. A dedicated team of capital finance specialists is responsible for financial management and accounting across Plymouth's capital programme; this team works closely with project officers and senior responsible officers as well as other finance specialists to maintain strong financial governance and oversight of the capital programmes. The capital finance team undertake regular training for project officers / project managers. The council complies with accounting standards relating to asset recognition and the recognition of capital grants, as well as statutory guidance governing the council's Minimum Repayment Provision (MRP) calculation policy; a local government accounting mechanism which ensures that the council makes sufficient provision to repay debt within its revenue budget. These standing internal, external and statutory control frameworks ensure that the principles of good financial management and stewardship are applied to capital investment within the City Council, mitigating the risk of mis-use of capital investment funds, misallocation of resources and fraud.
- 3.10 Plymouth City Council adopted a specific governance and control framework for capital projects in summer 2024, and currently all capital projects must be managed through a set of procedures set out in the council's internal Capital Handbook. As well as compliance with the council's wider constitutional decision-making process and Scheme of Delegation framework, capital projects are also overseen through specialist corporate governance boards (the Capital Programme Officer Group and the Capital Programme Board), which consider every material scheme prior to budget approval. Project risks are managed through project risk logs, with more significant risks escalated to departmental risk registers; more significant projects and programmes have supplementary governance boards operating at individual project / programme level. All of these control mechanisms ensure that decision-making and monitoring on capital investment projects is robust, and benefits from a wider collective oversight and specialist expertise, with internal challenge to mitigate the risk of optimism bias. The Council's constitutional decision-making process ensures that significant capital investment decisions are taken transparently and are open to public scrutiny.
- 3.11 As noted in paragraph 1.3 above, the council's project and programme management arrangements are in the process of being reviewed as part of wider learning following the Armada Way Independent Learning Review. The review will strengthen the council's existing governance structure for major projects, and improve the integration of specific capital project governance with the Council's wider internal control frameworks.