Annexe G

Capital Strategy

2018/19 – 2021/22

December 2018

BRACKNELL FOREST COUNCIL

CAPITAL STRATEGY

1 Purpose

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code requires local authorities from 2018 to produce a Capital Strategy to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and take account of stewardship, value for money, prudence, sustainability and affordability.

The Capital Strategy is a key document for the Council and forms part of the authority's integrated revenue and capital budget and balance sheet planning. It provides a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services. It also provides an overview of how associated risk is managed and the implications for future financial sustainability. It includes an overview of the governance processes for approval and monitoring of capital expenditure.

2 Scope

This Capital Strategy includes all capital expenditure and capital investment decisions. It sets out the long term context in which decisions are made with reference to the life of the projects/assets.

3 Capital Expenditure

Capital expenditure is incurred on the acquisition or creation of assets, or expenditure that enhances or adds to the life or value of an existing fixed asset that is needed to provide services. Fixed assets are tangible or intangible assets that yield benefits to the Council generally for a period of more than one year, e.g. land, buildings, roads, vehicles. This is in contrast to revenue expenditure which is spending on the day to day running costs of services such as employee costs and supplies and services.

The capital programme is the authority's plan of capital works for future years, including details on the funding of the schemes. Included are the projects such as the purchase of land and buildings, the construction of new buildings, design fees and the acquisition of vehicles and major items of equipment. Also included, if relevant, are commercial investments.

A detailed description of the Council's approach to ensuring that its land and property assets best serve day to day service requirements is set out in the

Corporate Asset Management Plan, which is a key supporting document of the Capital Strategy.

4 Treasury Management Investments

Treasury Management investment activity covers those investments which arise from the organisation's cash flows and debt management activity, and ultimately represent funds which need to be invested until the cash is required for use in the course of business.

For Treasury Management investments the security and liquidity of funds are placed ahead of the investment return. The management of associated risk is set out in detail in the Council's Treasury Management Policy and the Annual Investment Strategy.

The CIPFA Treasury Management Code recognises that organisations may make investments for policy reasons outside of normal treasury management activity. These may include service and commercial investments.

5 Commercial Investments

These are investments for policy reasons outside of normal treasury management activity. These are investments taken for mainly financial reasons and may include:

- investments arising as part of business structures, such as shares and loans in subsidiaries or other outsourcing structures
- investments explicitly taken with the aim of making a financial surplus for the Council.

Commercial investments also include fixed assets which are acquired and held primarily for financial benefit, such as investment properties. A Commercial Property Investment Strategy was approved by the Council in November 2016 setting out the due diligence required before considering an investment decision.

Due to the nature of the assets, such investments do not always give priority to security and liquidity over yield. In these cases, such a decision will be explicit, with the additional risks set out and the impact on financial sustainability identified and reported. The Council's approach to managing such risks is threefold:

- The overall level of investment in commercial properties has been capped at £90m, with the aim of achieving additional net rental income of £3m. This figure represents only 1% of the Council's gross revenue expenditure.

- The investment matrix adopted by the Executive Committee (Commercial Property) specifies a number of minimum criteria that need to be fulfilled before any property is considered for purchase, including particularly the strength of the tenancy and the age and condition of the building. Any potential investment opportunity that has not met these criteria has been rejected. The relatively low yields that the Council is receiving from purchases made reflects the market view that they represent a relatively low level of risk.
- The portfolio will be reviewed annually in the context of specific and general market conditions at the time in order to determine the optimum approach to each property, having regard to opportunities to re-negotiate existing leases or dispose of individual properties with a view to acquiring replacements to ensure that income generated is sustained by having a strong and balanced portfolio into the long-term. Given the high level of care taken to compile the current portfolio, it is unlikely that any changes will be made before 2022.

Within this clear framework, the Director of Finance and Borough Solicitor will ensure that the Council has the appropriate legal powers to undertake such investments and will continue to ensure the proportionality of all investments so that the Council does not undertake a level of investing which exposes it to an excessive level of risk compared to its financial resources.

6 Due Diligence

For all capital investments, the appropriate level of due diligence will be undertaken with the extent and depth reflecting the level of additional risk being considered.

Due diligence process and procedures will include:

- effective scrutiny of proposed investments by the relevant decision makers;
- identification of the risk to both the capital sums invested and the returns;
- understanding the extent and nature of any external underwriting of those risks;
- the potential impact on the financial sustainability of the Council if those risks come to fruition;
- identification of the assets being held for security against debt and any prior charges on those assets;
- where necessary independent and expert advice will be sought.

The Director of Finance will ensure that members are adequately informed and understand the level of risk exposure.

7 Council Objectives

The Council has agreed a number of corporate aims, priorities and objectives which guide its work. These are set out in the Council Plan. Capital investment projects must be in line with these overall objectives as well as individual service aims and objectives. The following processes are designed to ensure this happens.

8 The Capital Budget Setting Process

8.1 Identifying the need for Capital Expenditure/Investment

The need for a capital scheme may be identified by a Department through one or more of the following processes.

- Services prepare Project Approval Decision Sheets (PADS) identifying any capital investment needed to meet future service demands;
- The Corporate Asset Management Strategy (completed by Property Services alongside Service Departments) and the Education and Schools Asset Management Plans highlight deficiencies in the condition, suitability and sufficiency of the Council's existing building stock and identify future areas of need;
- The Local Transport Plan is a comprehensive and rolling plan of local transport strategies for achieving an integrated transport system to tackle the problems of congestion and pollution, looking at the roads and infrastructure needs of the Council;
- Reviews and external Inspections may also identify areas that need capital investment;
- The need to respond to Government initiatives and new laws and regulations;
- The desire to generate a revenue income to contribute to the funding of services.

These plans and review outcomes must be considered by Departmental Management Teams who must identify their key capital priorities for the relevant service planning period by the end of August each year.

Property schemes are initially considered by Asset Management Group and IT related investment is considered by the ICT Steering Group. Following the review process by these Officer groups final schemes are submitted to Corporate

Management Team as part of the overall Capital Programme Budget process in September each year, as part of the work to provide Members with choices around future year budget proposals.

8.2 Deciding which Schemes are to be included within the Council's Budget Consultation Proposals

Once the list of key capital priorities has been identified, consideration is given to the following by both Members and Officers

Prudence:

- Recognition of the capacity in the organisation to deliver such a programme;
- Recognition of the knowledge and skills available and whether these are commensurate with the appetite for risk;
- Recognition of the future vision of the authority;
- The approach to commercial activities including ensuring effective due diligence, expert advice and scrutiny, defining the risk appetite and considerations of proportionality in respect of overall resources;
- The approach to treasury management and the management of risk as set out in the Treasury Management Strategy.

Affordability:

- Revenue impact of the proposals on the Medium Term Financial Plan;
- The borrowing position of the Council, projections of external debt and the use of internal borrowing to support capital expenditure;
- The authorised limit and operational boundary for the following year;
- Whether schemes are profiled to the appropriate financial year.

Sustainability:

- A long-term view of capital expenditure plans, where long term is defined by the financing strategy of and risks faced with reference to the life of the project/assets;
- Provision for the repayment of debt over the life of the underlying debt as set out in the Minimum Revenue Provision policy;
- An overview of asset management planning including maintenance requirements and planned disposals.

Possible sources of funding can then be considered for each of the proposed capital schemes and the overall programme in total. Each project will also be considered in terms of revenue funding needed to cover the operational running costs of the asset in addition to the total borrowing repayment costs, and also how the asset will be funded in terms of capital expenditure.

8.4 Prioritisation of Schemes put forward

A formalised corporate system for prioritising capital projects has been adopted by the Council and used for many years. This has resulted in:

- Identifying essential capital investment for the next three financial years only;
- Utilising feasibility studies where needed;
- The ability to enter items into the capital programme in a managed way through the annual budget round;
- Being mindful of the current level of the programme in relation to capacity to deliver, the relevant financing of schemes and any other running costs.

This results in a list of capital project proposals to be considered as part of that year's budget approval process.

8.5 Member Approval Process

In autumn, managers will present the agreed list of key capital projects for their Service to the Corporate Management Team. These proposals are considered by Members in various forums including the Portfolio Review Group meetings before a final capital programme is published as part of the Budget Consultation in December.

A final Revenue and Capital Budget is then proposed by the Executive in February, reflecting any changes following the consultation process. Members also approve the overall borrowing levels at the budget meeting in February each year as part of the Treasury Management Strategy Report. The taking of loans then becomes an operational decision for the Director of Finance who will decide on the basis of the level of reserves and money market position whether borrowing should be met internally from the Capital Reserve/Capital Receipts or whether to enter into external borrowing.

Once the Council has approved the capital programme, then expenditure can be committed against these approved schemes subject to the normal contract procedure rules and the terms and conditions of funding.

Whether capital projects are funded from grant, contributions, capital allocations or borrowing, the revenue costs must be able to be met from existing revenue budgets or identified (and underwritten) savings or income streams.

Following approval by Council the capital programme expenditure is then monitored monthly and corporately reported on each quarter.

9 Monitoring of the Capital Programme Expenditure

Once the Capital Programme has been approved by members, the financial spend is monitored on a monthly basis. Monthly reports are prepared by Business Partners in conjunction with budget holders and sent to the Capital and Treasury Team, where they are collated and checked. Quarterly reports are reviewed by the Corporate Management Team and any decisions needed to ensure the programme stays within budget are taken.

A provisional and final Out-Turn report is provided to the Executive at the end of each financial year.

10 Multi-Year Schemes

Payments for capital schemes often occur over many years, depending on the size and complexity of the project. Therefore, estimated payment patterns are calculated for each project so that the expected capital expenditure per year is known. This is called a cash flow projection or budget profiling.

The approval of a rolling multi-year capital programme assists the Council in a number of ways. It assists service managers, allowing them to develop longer term capital plans for service delivery. It allows greater flexibility in planning workloads and more certainty for preparation work for future schemes. It will also allow greater integration of the revenue budget and capital programme. It also matches the time requirement for scheme planning and implementation since capital schemes have a considerable initial development phase.

11 Funding Strategy and Capital Policies

This section sets out the policies of the Council in relation to funding capital expenditure and investment.

11.1 External Funding

Services must seek to maximise external funding wherever possible to support capital schemes. This can be in the form of grants and contributions from outside bodies including central government.

11.2 Capital Receipts

A capital receipt is an amount of money which is received from the sale of an asset. Capital receipts cannot be spent on revenue items.

The Property Review Group will review all of the Council's property annually against the aims and objectives of the Corporate Asset Management Strategy. The general policy is that any capital receipts are then pooled and used to finance future capital expenditure and investment according to priorities, although they may be used to repay outstanding debt on assets financed from loans, as permitted by the regulations.

11.3 Revenue Funding

Services may use their revenue budgets to fund capital expenditure. The Director of Finance needs to take an overview and decide where this is appropriate, having regard to the Council's overall financial resources.

11.4 Prudential/Unsupported Borrowing

Local Authorities can set their own borrowing levels based on their capital need and their ability to pay for the borrowing. The levels will be set by using the indicators and factors set out in the Prudential Code. The borrowing costs are not supported by the Government so services need to ensure they can fund the repayment costs. This borrowing may also be referred to as Prudential Borrowing.

Capital projects that cannot be funded from any other source can be funded from Prudential Borrowing. The Council must be able to afford the borrowing repayment and interest charges on the loan and for this to be factored into the medium term financial strategy accordingly.

The Director of Finance will make an assessment of the overall prudence, affordability and sustainability of the total borrowing requested. The impact of this borrowing will be reported in the Treasury Management Strategy alongside the Prudential Indicators required by CIPFA's Prudential Code for Capital Finance.

The view of the Director of Finance will be fed into the corporate bidding process so that, should the borrowing levels be unaffordable or not prudent, then the schemes will be prioritised against the available funding from borrowing using the corporate prioritisation system.

11.5 Invest to Save Schemes

Each year the Council is asked to agree a £1m budget for Invest-to-save schemes. These are defined as schemes that can pay for the cost of borrowing and principal repayment within the life of the asset. These are approved by Corporate Management Team throughout the year based on a business case and the savings required to fund the investment are added to the Commitment Budget for the relevant service. If the additional savings/income does not cover the additional costs incurred, then the service will be required to fund the gap from their existing budgets (i.e. they will underwrite the savings/income).

11.6 Leasing

The Director of Finance may enter into finance leasing agreements to fund capital expenditure. However, a full option appraisal and comparison of other funding sources must be made and the Director of Finance must be certain that leasing provides the best value for money method of funding the scheme.

Under the Prudential Code finance leasing agreements are counted against the overall borrowing levels when looking at the prudence of the authority's borrowing.

12 Procurement and Value for Money

Procurement is the purchase of goods and services, with a strategy being developed to assist with the definition of quality standards and securing provision of the best possible services for local people for a given price.

The Council has a Procurement team that ensures they provide value for money and to see where efficiency savings can be achieved. This also covers capital procurement.

It is essential that all procurement activities comply with EU procurement directives and adhere to the relevant requirements stipulated in directives. Guidance on this can be sought from the Procurement team. Procurement must also comply with the Councils policies and regulations such as Contract Procedural Rules and Financial Regulations.

The main aim is to hold 'value for money' as a key goal in all procurement activity to optimise the combination of cost and quality.

13 Partnerships and Relationships with other Organisations

Wherever possible and subject to the usual risk assessments services should look to expand the number of capital schemes which are completed on a partnership basis and continually look for areas where joint projects can be implemented.

14 Management Framework

The governance structure of the Council has the Corporate Management Team that takes a corporate and group view on the capital programme and investment.

The Corporate Management Team will also ensure a corporate and group portfolio perspective to the use and allocation of the Council's capital assets and those within its control, and in planning capital investment. The team receives reports on proposed capital projects and recommends to the Executive proposals for the development of the capital programme.

15 Performance Management

Clear measurable outcomes should be developed for each capital scheme. After the scheme has been completed, services should check if outcomes have been achieved.

16 Risk Management

Risk is the threat that an event or action will adversely affect the Council's ability to achieve its objectives and to execute its strategies successfully.

Risk management is the process of identifying risks, evaluating their potential consequences and determining the most effective methods of managing them and/or responding to them. It is both a means of minimising the costs and disruption to the organisation caused by undesired events and of ensuring that staff understand and appreciate the element of risk in all their activities.

The aim is to reduce the frequency of adverse risk events occurring (where possible), minimise the severity of their consequences if they do occur, or to consider whether risk can be transferred to other parties. To manage risk effectively, the risks associated with each capital project need to be systematically identified, analysed, influenced and monitored.

It is important to identify the appetite for risk by each scheme and for the capital programme as a whole, especially when investing in capital assets held primarily for financial returns. Under the CIPFA Prudential Code these are defined as investments and so the key principle of control of risk and optimising returns consistent with the level of risk applies.

The Director of Finance will report explicitly on the affordability and risk associated with the Capital Strategy. Where appropriate he will have access to specialised advice to enable him to reach his conclusions.

16.1 Credit Risk

This is the risk that the organisation with which we have invested capital monies becomes insolvent and cannot pay us our investment returns or complete the agreed contract. Accordingly, the Council will ensure that robust due diligence procedures cover all external capital investment. Where possible contingency plans will be identified at the outset and enacted when appropriate.

16.2 Liquidity Risk

This is the risk that the timing of any cash inflows from a project will be delayed, for example if other organisations do not make their contributions when agreed. This is also the risk that the cash inflows will be less than expected, for example due to the effects of inflation, interest rates or exchange rates. Our exposure to this risk will be monitored via the revenue and capital budget monitoring processes. Where possible appropriate interventions will occur as early as possible.

16.3 Interest Rate Risk

This is the risk that interest rates will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Interest rates will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

16.4 Exchange Rate Risk

This is the risk that exchange rates will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Where relevant, exchange rates will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

16.5 Inflation Risk

This is the risk that rates of inflation will move in a way that has an adverse effect on the value of capital expenditure or the expected financial returns from a project. Rates of inflation will be reviewed as part of the on-going monitoring arrangements to identify such adverse effects. As far as possible our exposure to this risk will be mitigated via robust contract terms and when necessary contract re-negotiations.

16.6 Legal and Regulatory Risk

This is the risk that changes in laws or regulation make a capital project more expensive or time consuming to complete, make it no longer cost effective or make it illegal or not advisable to complete. Before entering into capital expenditure or making capital investments, the Council will understand the powers under which the investment is made. Forthcoming changes to relevant laws and regulations will be kept under review and factored into any capital bidding and programme monitoring processes.

16.7 Fraud, Error and Corruption

This is the risk that financial losses will occur due to errors or fraudulent or corrupt activities. Officers involved in any of the processes around capital expenditure or funding are required to follow the Council's policies and procedures.

17 Other Considerations

Capital schemes must comply with legislation and also Council policies. Reference should also be made to other strategies and plans of the Council.

Important Linking Documents for reference are:

- The Council Plan;
- Corporate Asset Management Strategy;
- Education Asset Management Plan;
- Local Transport Plan;
- Individual Service Plans;
- Procurement Strategy;
- Financial Regulations;
- Contract Standing Orders;
- Treasury Management Strategy;
- Minimum Revenue Provision Policy.