Appendix 4

Hyndburn Borough Council

Capital Strategy 2020/21

Contents

1 Overview

The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code requires local authorities 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, capital 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, not only as an individual local authority but also those entered into under group arrangements. It sets out the long term context in which decisions are made with reference to the life of the projects/assets.

The Capital Strategy :

- States the council's processes for:
  - project initiation
  - deciding on the prioritisation of capital projects
  - monitoring and evaluating schemes
- Takes account of significant revenue implications
- Provides a framework for the management and monitoring of the capital programme
- Identifies funding and provides a basis to inform bidding for additional capital resources (eg from the National Lottery, government initiatives)
- Apprises the corporate review of existing properties

The Capital Strategy considers all aspects of the Council's capital expenditure and extends to areas where the Council is able to influence others through the use of its capital resources. It forms part of the Council's integrated revenue, capital and balance sheet planning.

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 could be service and commercial investments.

4 Capital vs. 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 balances 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 the 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 Service and Commercial Investments

These are investments for policy reasons outside of normal treasury management activity. This may include:

Service investments

These are investments held clearly and explicitly in the course of the provision, and for the purposes, of operational services, including regeneration.

Commercial investments

These are investments taken for mainly financial reasons. These may include:

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

Commercial investments also include fixed assets which are held primarily for financial benefit, such as investment properties.

Due to the nature of the assets or for valid service reasons, 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 Deputy Chief Executive will ensure that the Council has the appropriate legal powers to undertake such investments.

6 Council Objectives

The Council has agreed a number of corporate aims, priorities and objectives which guide its work. These are set out in the Corporate Plan and Medium Term Financial Strategy (MTFS). 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.

7 The Capital Budget Setting Process

7.1 Identifying the need for Capital Expenditure

The need for a capital scheme is be identified by a Service Manager and a bid is submitted to the Autumn Capital Programme Working Group.

Capital projects are subject to robust justification process, bringing together a clear business case with sufficient detailed costings to ensure transparent decisions can be taken.
Proposals are reviewed in terms of validation arrangements and estimated figures.
To ensure project delivery is achievable project management arrangements are undertaken with ownership and responsibility of projects siting in the initiating department.
The capital bids are discussed and prioritised at Capital Programme Working Group. This report is then considered by Corporate Management Team. The recommendations are given to members for their discussion and input. The final report is then submitted to Cabinet and then Full Council.

7.2 Criteria used to decide which schemes are recommended.

Capital projects will be assessed for:

- Strategic fit – corporate objectives are being met by the expenditure
- Identified need – eg vital repairs and maintenance of existing assets
- Achievability – this may include alternatives to direct expenditure by the Council such as partnerships with others, rent or buy options, alternative delivery vehicles
- The scheme is deliverable by the Council within its resources, skills and legal constraints
- Acceptable risk levels
- Reduces future capital or revenue spend
- Practicality and deliverability
- Revenue generation
- The scheme has a good gearing ratio
- Maintains or enhances service provision
- Provides value for money for the taxpayer
- Provides long term benefits
- Has a positive environmental and social impact.

Additionally, consideration should be given to:

Prudence:

- Recognition of the capacity in the organisation to deliver such a programme;
- 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:

- 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.

All bids are produced in line with the appropriate timetable with consideration for the financial information contained within the bid.

Portfolio Holders must be briefed and understand the service need and the budget consequences, both revenue and capital, of completing the scheme.

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

The proportionality of the proposals as a whole will then be considered in respect of overall resources and longer term sustainability and risk. The Deputy Chief Executive will take an overall view on the prudence, affordability and sustainability of the overall borrowing level if all bids are accepted.

Once the Deputy Chief Executive has taken a view of the prudence of the overall borrowing level, the Corporate Management Team will then consider the bids from a corporate priority perspective.

7.3 Member Approval Process

In autumn, the Deputy Chief Executive will present the agreed list of key capital projects to the Corporate Management Team. At this stage funding details are sometimes unavailable, as Government funding allocations are announced later in the year. The presentations inform Members of the key projects to be completed over the next year.

Where appropriate schemes will be reported to Members based on the schemes being subject to external funding approval.

These overall capital programme totals are then reported to Cabinet Members as part of the annual budget process, who then make recommendations on the overall capital programme.

The Cabinet receives the Capital Programme in February each year and makes their recommendations to full Council.

Members approve the overall borrowing levels at the budget meeting in February each year as part of the Treasury Management Report. The taking of loans then becomes an operational decision for the Deputy Chief Executive who will decide on the basis of the level of reserves and money market position whether financing 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. Before expenditure commences an “Approval to Spend” form is completed by officers and authorised. This confirms the profile of expenditure and confirmation that any external grant allocation has been obtained.

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.

8 Monitoring of the Capital Programme Expenditure

Once detailed capital programmes have been approved by members, the financial spend is monitored at Capital Programme Working Group on an alternate monthly basis.

The Council will assign a Project Manager to each project to oversee planning, delivery, management and governance of capital projects.

9 Multi-Year Schemes

Payments for capital schemes often occur over several 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.

10 Funding Strategy and Capital Policies

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

Proposals for capital projects must identify the funding requirements for the timescale of the project including any revenue implications. Funding must be appropriate for the project and will come from:

- Reserves
- Capital receipts – from the sale of assets or finance lease receipts
- Government grants – such as disabled facilities grant funding
- Third party grants and contributions
- Revenue contributions
- Other developer contributions

- External (prudential) borrowing

Any restrictions on borrowing or funding of ongoing capital finance will be assessed. Project appraisal will consider additional or alternative funding sources, match funding opportunities, bidding timeframes and the likely success of being awarded a grant. Other funding sources may include national lottery, government grant, heritage lottery fund etc.

10.1 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. However, services must underwrite any cost overruns on externally funded schemes. If services bid for external funding for schemes and say at tender or during construction or procurement, costs exceed the available funding, then services must fund any shortfall from their existing resources (either revenue or capital).

In respect of match funding bids then the relevant service must fully identify the necessary match funding resources from within existing service budgets. If this is not possible then the appropriate service must raise this for consideration with the members of the Corporate Management Team and the relevant Portfolio Holder prior to submitting any bid for funding.

10.2 Capital Receipts

A capital receipt is an amount of money exceeding £10,000 which is received from the sale of an asset. They cannot be spent on revenue items.

The Deputy Chief Executive will review all of the Council’s property annually. 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.

10.3 Revenue Funding

Services may use their revenue budgets to fund capital expenditure. The revenue reserve may also be used to finance capital expenditure as an alternative to external borrowing.

The Head of the Service and the Deputy Chief Executive will need to take an overview and decide the most appropriate way of funding their service areas.

10.4 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 and set out in the Treasury Management Statement. 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. Services must be able to afford the borrowing repayment and interest charges on the loan from existing revenue budgets or the Council must see this as their key priority for the budget process and to be factored into the medium term financial strategy accordingly.

The Deputy Chief Executive 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 Deputy Chief Executive 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.

The Deputy Chief Executive will also determine whether the borrowing should be from internal resources such as the Revenue/Capital Reserve or whether to enter into external borrowing.

10.5 Leasing

The Deputy Chief Executive may enter into finance leasing agreements to fund capital expenditure on behalf of services. However, a full option appraisal and comparison of other funding sources must be made and the Deputy Chief Executive must be confident 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.

11 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.

It is essential that all procurement activities comply with EU procurement directives and adhere to the relevant requirements stipulated in directives. 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.

12 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.

13 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.

14 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.

Post scheme evaluation reviews should look at the effectiveness of the whole project in terms of service delivery outcomes, design and construction, financing etc. and identify good practice and lessons to be learnt in delivering future projects.

15 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 Deputy Chief Executive will report on the affordability and risk associated with the Capital Programme.

An assessment of risk should therefore be built into every capital project.

15.1 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.

15.2 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.

15.3 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.

15.4 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.

15.5 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.

15.6 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. This is supported by the Employee Code of Conduct and detailed policies such as Anti-Fraud and Corruption, Anti Money Laundering, Whistle Blowing and Declaration of Interests.

16 Other Considerations

Capital Schemes must comply with legislation, such as the Disability Discrimination Act, and also Council policies, Contract Procedure Rules and Financial Regulations. Reference should also be made to other strategies and plans of the Council.

Important Linking Documents for reference are:

- Corporate Plan;
- Corporate Asset Management Strategy;
- Individual Service Plans;
- Procurement Strategy;
- Financial Regulations;
- Contract Procedure Rules;
- Treasury Management Strategy;
- Minimum Revenue Provision Policy.
- Medium Term Financial Strategy