CORPORATE CAPITAL STRATEGY

2016/17 REVISION

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Appendix 1 - Definition of Capital Expenditure

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1. Introduction

The Corporate Capital Strategy forms part of the Council's Budget as it sets out the principles to be used in 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.

Capital investment is technically described as: Expenditure on the acquisition, creation, or enhancement of 'non current assets' i.e. items of land, property and plant which have a useful life of more than 1 year. A fuller definition is attached at Appendix 1. Expenditure outside this definition will be, by definition, revenue expenditure.

Most non current assets are properties that are used in service delivery. The Council's land, buildings and infrastructure asset base of some 2,300 properties has a current use Balance Sheet value of approx. £300 million. In addition the Council has an interest in assets held by Diocese and Foundation schools and assets of companies the Council has a financial interest in such as Torbay Development Agency.

Although the 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 is presented to Council as part of the Budget and links with the Treasury Management Strategy and in particular the Corporate Asset Management Plan. Both documents are available from Council offices and on the Council's Website:

http://www.torbay.gov.uk/index/yourcouncil/financialservices

The Capital Strategy sets out the guiding principles on the following elements:

- Approach to Borrowing
- Grant Allocation
- Capital Receipts
- Revenue and Reserves
- Prioritisation and Approval
- Alternative Funding and Delivery Options
- Investment Opportunities

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 summary document 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

In light of the significant ongoing financial challenges facing the Council the Council will prioritise capital projects that result in increased income to the Council.

No capital funding to be allocated to projects unless funding confirmed or realised in particular capital receipts and contributions.

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 repayment and interest costs as there is no longer any central government "supported borrowing" allocations and related revenue support.

The Council is only able to borrow for “unsupported borrowing” (also known as Prudential Borrowing) 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.

The Council’s approved 2015/16 Treasury Management Strategy was to continue to reduce the level of Council borrowings over four years which implied that no new major prudential borrowing schemes will be approved. However the proposed capital plan for 2016/17 combined with prudential borrowing already approved in 2015/16 will reverse that strategy for 2016/17 resulting in a need to borrow over the next four years.

The Council has historically taken a cautious 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 on Council Tax). In the light of the recent Corporate Peer Review the Council is encouraged to be less risk averse. However it is still essential that any new proposals for a self funding or invest to save scheme supported by borrowing has a robust business case that is presented to senior members and officers prior to approval by Council.

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 repairing the asset to the overall economy of the Bay. 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. In light of the restrictions on both revenue and capital funds over the next few years the Council will take a more pragmatic approach to funding this type of scheme by using prudential borrowing and spread the costs over a number of years.

2.2 Grants

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 un ring fenced and without conditions, however this funding is at levels significantly lower 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 may be taken into account in determining allocations.

Any un-ring fenced 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 specific service by Council, individual schemes within that allocation are subject to each individual scheme being approved by the relevant Director or Executive Head in consultation with the relevant Executive Lead.

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 with the Mayor and Executive Director prior to submission.

2.3 Capital Receipts and Capital Contributions

The Council receives capital receipts and capital contributions from:

- Asset Disposals
- Right to Buy Clawback
- S106 and Community Infrastructure Levy - CIL (after Council approves policy)
- 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 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. 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.

Under the Council's constitution the approval for the disposal of an asset is an Executive (Mayoral) function. The Mayor however will take regular reports on assets identified for disposal to full Council.

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.

The Council has previously approved, in line with legislation, that revenue costs of disposals, up to 4% of the disposal value can be accounted for as capital expenditure.

Asset Disposals at nil consideration or below market value.

In considering asset disposals, the Council also needs to take into account the policy on Community Asset Transfers where if applicable in line with the Asset Management Plan, the Council will consider, 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 should be approved by Council. 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, which will not require Council consent.

Right-to-Buy Clawback

100% of these receipts will support the provision of the housing functions.

S106 contributions and Community Infrastructure Levy (CIL)

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 line with Council's capital scheme priorities.

Any monies received for infrastructure from the Community Infrastructure Levy (when introduced) will not be allocated to a specific service but will be allocated under the CIL arrangements ("the 1,2,3 List") in line with Council's capital scheme priorities including any specific funding requirements such as the South Devon Highway or a specific scheme to increased school places.

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 that has not yet been met. 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 approved and accounted for as capital expenditure. The repayment of 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 outstanding loan.

2.4 Revenue & 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.

The Council will take a pragmatic view where reserves and revenue are being proposed to fund a capital project and consider whether prudential borrowing should be used instead to spread the cost over a number of years and in the short term use the revenue and reserve funding for other priorities.

2.5 Prioritisation and Approval

It is always difficult to make choices between competing priorities within a top tier Council that delivers so many varied services. In light of the significant ongoing financial challenges facing the Council the Council will prioritise capital projects that result in increased income to the Council. 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 plan or project outline. Business plans are to be submitted to the Executive Director in consultation with the Mayor/Executive Lead for Finance and Chief Finance Officer:

> If a scheme is to be funded from (previously approved) allocations the scheme will be approved by the Executive Director in consultation with the Mayor/Executive Lead for Finance and Chief Finance Officer and progressed when funding confirmed or,
>
> If new (confirmed) funding is to be used for a scheme to be funded by, say, a specific grant and if the scheme is supported by Executive Director in consultation with the Mayor/Executive Lead for Finance and Chief Finance Officer it will be reported to Council.

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 are subject to each individual scheme being approved by the Executive Head in consultation with the relevant Executive Lead.

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 Executive Director in consultation with the Mayor/Executive Lead for Finance and Chief Finance Officer. If the scheme is supported it will be recommended to Council for approval.

3) The Capital Plan will be updated and any recommendations for schemes to be approved by Council included in the next quarterly Capital Plan Update Report.

4) Other 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.

2.6 Alternative Funding and Delivery Opportunities

As Council capital funding is reduced the Council will continue to consider alternative methods of supporting capital expenditure within the Bay, 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 work with other bodies to secure capital investment or consider use of its own assets in a development, 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 along with an assessment of the opportunity costs of alternative options. All schemes are to be agreed with the Mayor and Executive Director prior to submission and/or contractual commitment.

2.7 Investment Opportunities

Linked to its approach to borrowing and its Treasury Management 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. This could include the purchase of land or property or the purchase of “shares” in a property fund. Depending on the capital funding proposed the appropriate approvals will be requested including approval within the Treasury Management Strategy.

Appendix 1 - 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 & 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 01/04/10) 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". i.e if building a school – 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 i.e 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.