Appendix O

CAPITAL STRATEGY 2019/20 to 2024/25

1. Introduction

1.1. As a result of changes to the Prudential Code and statutory requirements in relation to Non-Treasury Management investments(for example commercial and retail investments not related to local economic development), the Council is required to prepare, give due consideration to and approve as part of the budget process and long term financial planning; a Capital Strategy.

1.2. A Capital Strategy, provides the foundation of robust and effective long-term planning (financial and non-financial) for capital investment by the Council both in its own operational assets, as a partner in economic redevelopment, and in the provision of social care, social housing and community services within its local area.

1.3. In addition, as a result of the 'commercialisation' agenda and the need to close ongoing budget gaps, many Local Authorities are considering 'commercial investments' both within and out with their local boundaries; and investment in other organisations to support public services (for example investment in Local Authority companies to deliver services – 'service investments'). Both these investments are classified as 'Non Treasury Management' Investments

1.4. Under the prudential framework, Local Authorities are required to consider and identify their risk appetite for treasury investment and manage these risks appropriately. The updated prudential framework clarifies that the same evaluation and management of risk should be taken for Non-Treasury Management investments such long term property investment; and that these requirements be set out in the Council's prudential framework and capital strategy. Thus ensuring that investment and associated funding decisions are taken with full knowledge and management of the associated risks and with a view to deliver sustainable long term financial planning.

2. Context

2.1. The Council's operational assets are one of its most valuable resources in delivering services for the benefit of its local community. The Council's Property, Plant and Equipment, Heritage and Intangible assets account for 88.8% of the Council's gross balance sheet value of £608.929m as at 31 March 2018. The most significant Council owned operational assets are the housing stock of 5945 properties, with a net value of £344.203m as at 31 March 2018.

2.2. As at 31 March 2018, the Council held £39.9m in Investment properties (commercial investments); comprising 104 commercial and retail properties, 3 carparks and 18 other sites, all within the district. The total net income from these properties was approximately £2.0m, which reflected 0.01% of the Council's net spend in 2017/18. Providing a yield of return of 5%.This level of non-treasury management investment is not disproportionate to the Council's total income stream; therefore presenting at present minimal risk to long term financial planning and ongoing service delivery were rental incomes for these properties to materially reduce. However, going forward the Council needs to set its risk appetite for these investment and related monitoring requirements to manage potential volatility in income. This becomes more important as the investment portfolio develops to include service investments.

2.3. As yet, the Council has not made any investments in its various Local Authority Companies to support future service delivery. A temporary loan of £0.462m has been made to subsidiaries within Amphora Holdings Ltd, to provide cashflow support in the short term. This loan is repayable on 31 March 2019.

2.4. Effective asset planning ensures that the Council's assets maintain their value, full operational capability and provide maximum income generation where required; supporting the Council's long term service objectives.

2.5. In addition the Council manages external funding (S106 contributions and external funding via grants) of £8.8m as at 31 March 2018 to deliver projects and new assets which support regeneration, facilitate social care requirements and community aspirations.

2.6. After numerous years of rationalising its operational assets and the downturn in council house sales, the Council has limited capacity to generate capital receipts apart from its available land and local commercial holdings. Therefore, in capital investment terms, the Council has become a facilitator in terms of sourcing and managing external public and commercial funds for local investment in line with the Council's Strategic Plan.

2.7. The overarching aim of the 2019/20 to 2024/25 Capital Strategy is to provide a framework within which the Council's capital investment plans are to be delivered. It has been prepared to cover a five year timeframe; however recognising that there are some uncertainties in relation to later years, the Strategy focuses on 2019/20 to 2021/22 in detail.

2.8. To be effective the Capital Strategy needs to link to the Local Plan, the Council's corporate objectives and various strategies; including the Medium Term Financial Strategy, Treasury Management Strategy and Prudential Code, Asset Management Strategy, Economic Development Strategy, Housing Revenue Account Business Plan and Asset Management Plan, etc.

2.9. The draft Local Plan (2017-2033), which was submitted to the Planning Inspector in October 2017 outlines the strategy for growth in the district to 2033 and beyond, setting the vision, long term aims and aspirations for the local area. The key element of the draft Plan is the identification of the ambition for high-quality, strategic scale development in North Essex.

2.10. Given the following factors, the Council has a significant part to play as a key enabler in delivering the Local Plan:

- owner of substantial land and property holdings for economic development,
- enabler for both government and other external funding,
- negotiator for S106 planning contributions and obligations.

2.11. The Council's capital investment plan is driven by the Council's Strategic Plan, which is linked to the Local Plan. The Strategic Plan is the Council's key strategic document and outlines the Council's contribution, both as facilitator and enabler in delivering the Local Plan and local strategic objectives. The Strategic Plan was approved by the Council in February 2018 and identified 8 key themes:

- Create Transport for Colchester
- Clean up and Promote the Town Centre
- Fight Crime and Improve Community Safety
- Reduce Homelessness
- Enterprising Colchester
- Sports and Health for All
- Reform and Refresh – to look at alternative delivery models for services and identify efficiencies in delivering services
- Co-operation – to work with all those wanting to improve life and prospects within the Borough

2.11 In order to prioritise limited capital resources, the capital strategy and associated capital projects need to align and achieve determined outputs in relation to the key themes within the Strategic Plan.

3. The principles of the Capital Strategy

3.1 The overarching principles of the Capital Strategy are detailed below:

- The Council will set and approve the strategic direction of the Council's long term capital investment and funding allocation; by approving an annual capital strategy. The strategy will be approved as part of the budget setting process and considered alongside with:
  - The General Fund budget setting report (including the capital programme) and Medium Term Financial Plan,

    - The Housing Revenue Account Business Plan, associated budget report, capital asset management plan and Housing Investment Programme, and
    - The Treasury Management Strategy and prudential framework.
- The Housing Revenue Account (HRA) investment Programme (HIP) will be approved by Council annually in conjunction with the HRA business plan and asset management plan and associated budget report. The funding of the five year HIP will be in line with the funding priorities identified at paragraph 5.3.7
- Cabinet (including the Revolving Investment Fund Cabinet Committee) will approve new capital investment and associated funding in line with the principles of the capital strategy and on the basis of a robust business case.
- The priority in delivering the capital strategy will be to support all schemes already approved in the capital programme and contractually committed to enable schemes to proceed and complete.
- Robust review and scrutiny of the capital programmes progress (both in financial and non-financial terms) will be undertaken on a quarterly basis by members of the Audit and Governance Committee and Scrutiny Panel, with any recommendations from these forums being referred to Cabinet. In addition, senior officers undertake internal review and challenge on a quarterly basis through Project Management Board.
- The Council set up and maintains a Revolving Investment Fund (RIF), to improve the commercial management of the Council's disposal of assets, capital investment and drive forward long term income generation projects. The governance of the fund is the responsibility of the RIF Cabinet committee. In line with these objectives the key mechanics of the RIF are:
    - Develop and set reinvestment strategy for a rolling 5 year programme, including the establishment of high rental growth projects and agree annual capital funds to be set aside for capital investment.
    - Ensure robust project management processes are in place to identify and manage projects within the RIF and associated funding requirements, and related risks.
    - Capital receipts generated by RIF projects are to be reinvested in the RIF to fund future projects.
- The Council will maximise the application and community benefit realised as a result of S106 financial and non-financial contributions. Appropriate records will be maintained and action planned to ensure that the Council fulfils its obligations under individual S106 agreements.
- With regards to non-treasury management investments, the Council will formalise the required performance and risk criteria for such investments, which will be required to be met. Ongoing monitoring arrangements will also be formalised, to enable effective due diligence and management of the Council's risk appetite.
- The Council will consider any option for external funding (central government, other public bodies or private sector) of capital investment in line with its strategic objectives. Proposals will be robustly reviewed, with match capital funding being identified and prioritised and long term revenue implications and financial liabilities for the Council, being comprehensively and clearly

identified and included in the Council's Medium Term Financial Plan as appropriate.

4. Priority Areas for Investment

4.1 The priority investment areas identified for the 2019/20 to 2024/25 period are covered below. Future schemes will be taken forward subject to available resources and the approval by Cabinet of a relevant business case.

Existing programme

4.2. There is a requirement for the continued funding on existing key schemes:

- Mercury Theatre redevelopment Phase 2 – Forecast cost of c£6.4m for the period 2018/19 to 2020/21, with external funding totalling c£5m and Council funding of c£1m.
- The first phase of the replacement of the Council's vehicle fleet, including waste and street cleaning vehicles - £4.9m for 2018/19 to 2020/21. A substantial part of the Council's vehicle fleet is leased, a financial review has identified cost savings for the council where the fleet is directly purchased and maintained on a contract basis.
- Disabled Facilities Grants – total budget £2.657m to support private sector tenants to remain in their own homes. Funding over a four year period from 2018/19 of which £1.993m financed from central government grant.
- Financial support to the Council's Commercial companies to deliver investment in housing and regeneration and provide a long term income return for the Council through various commercial undertakings - c£41m
- Various RIF schemes to deliver investment in the local area and generate long term revenue and capital income for reinvestment – c£37m.
- Ongoing investment in the Council's Housing stock and repurchase of Right to Buy properties to add to the housing stock - £12.808m for 2018/19.

4.3 In addition the following new schemes will require approval to progress and consideration for future funding:

- The ongoing replacement of the Council's vehicle fleet,
- Development of sports, leisure and health facilities within the district, supported with external funding,
- Town Centre regeneration,
- The ongoing development of commercial property on Council land to generate long term revenue income, and
- Housing Investment Programme (HIP) 2019/20 to 2024/25 totalling £117.295m, agreed in principle by Cabinet for ongoing stock investment and adaptions, development of new housing stock(including the ongoing redevelopment of garage sites) and acquisitions(including buy back of Right to Buys). A report elsewhere

on this agenda details the 2019/20 HIP to be approved totalling £20.851m and provides details of ongoing investment for the HRA.

5. Capital Resources to Support Capital Investment

5.1 The Council's strategy for deploying resources is to ensure that all resources are utilised effectively to achieve the Council's long term investment objectives in line with the Strategic Plan, even where resources are available through national initiatives.

5.2 Cabinet and the RIF will evaluate and approve all bids for resources and approve any revisions to the capital programme.

5.3 There are a range of methods of funding the Council's capital investment:

5.3.1 Capital Receipts

Apart from Housing Revenue and RIF capital receipts, the Council will ensure that it takes full advantage of the freedom and flexibility arising from the withdrawal of national ring-fencing of capital receipts. In addition, all non ringfenced capital resources will be pooled into a corporate capital resource. This resource will be managed so that only schemes which can demonstrate the attainment of Council capital priorities will be allocated funds.

As the Council has limited capital receipts which are not ringfenced, the Council is unable to make use of MHLG dispensation to use these resources for transformational projects which are expected to deliver future ongoing revenue savings up until 2022. Should this provision become feasible for application locally, the Council will reconsider the use of this government dispensation.

5.3.4 Government and other Public Sector Funding

Government Grants for Capital schemes are usually ringfenced, that is they have restricted use to deliver a particular scheme and outputs. For example Disabled Facilities Grants, Arts Council funding, etc.
Where there is a requirement to make an application for government funding, with the requirement for match funding from Council resources; a business case is required to be prepared and reported to the relevant body responsible for governance. This must justify the bid for resources prior to the application for funding, to ensure that those charged with governance are aware of the terms of funding and the associated risks in delivering the scheme and abiding by the required restrictions.

5.3.3 S106 Contributions

S106 of the Town and Country Planning Act 1990;enables local authorities to negotiate a 'planning obligation' to either improve the quality of the development or overcome difficulties which would otherwise result in planning permission being refused. The Council may receive funds to enable it to undertake works arising from these obligations, for example provision of affordable housing, improved transport facilities, provision of additional open space, etc.
The council is bound by the conditions of the funding agreements and failure to deliver the planning obligation in line with the agreement, will result in funding being repaid.

5.3.4 Revenue Contributions

Revenue resources can be used to fund capital investment as long as it can be proven that the revenue budget is not restricted and is within budget.

5.3.5 Capital Expenditure and RIF Reserves

These two revenue reserves can be used to finance future capital investment.

5.3.6 Use of Leasing

Some of the Council's assets are currently financed by a lease arrangement, for example refuse vehicles and street sweepers. With the reduction in interest rates and the Council's policy of financing new assets from internal borrowing, this finance option has become more expensive. The Council will consider leasing arrangements which could offer value for money.

5.3.7 Funding Housing Revenue Account Investment

For HRA capital investment, source of resources, and the priority order in which it is assumed they will be used to fund capital expenditure in the 2019/20 HIP budget and financial forecasts are as follows;

- Specific Areas of Finance (e.g. Grants),
- Capital Receipts,
- Major Repairs Reserve (Depreciation),
- Revenue contributions to capital (RCCO),
- New Additional Borrowing

The assumption made when prioritising resources to fund the HIP is that resources specifically designated to the programme will be used first, followed by capital receipts. This is so the receipts can be re-invested in affordable housing, and be retained locally and not be clawed back by Central Government under the capital receipts pooling arrangements. The next form of resource to be used is the Major Repairs Reserve, which is the reserve that is built up from the depreciation charge to the HRA. This is the resource that is set aside to maintain the housing stock in its current form & condition. If there are insufficient resources within the

Major Repairs Reserve to fund all of the capital works in the year, then the next call on funding is revenue. The amount of this resource will depend on the level of balances within the HRA and the extent to which they are directed to the HIP, as opposed to other budget priorities.

Finally, should there be insufficient revenue resources to fund the overall programme the assumption is that the Council will undertake HRA borrowing to fully fund the HIP. This is assumed to be the lowest priority source of funding, to minimise the resultant additional interest costs that would be incurred by the HRA. Further borrowing will be undertaken following the Council's Treasury Management Strategy and prudential borrowing code. The Council has a statutory duty to self-manage its external borrowing and ensure that it is affordable in the long term. For the HRA, this has become more important with the removal of the 'debt cap' in the October 2018 Budget announcement.

Should the Council decide it does not want to undertake additional HRA borrowing or use revenue resources etc, then the Council would need to re-consider the programme of works proposed and the corresponding budget provision. This could include foregoing works, or re-profiling the year in which they are undertaken.

5.3.8 Private Finance Initiatives

This method of funding can be used to fund major new schemes, such as infrastructure, schools, etc. Such schemes involve partnership between public and private sector, funding public sector capital investment from private capital. The Council has no such schemes at the moment and there is no intention to fund capital investment this this way.

6. Knowledge and skills

6.1 The Council employs qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Where Council staff do not have the knowledge and skills required, use is made of external advisors and consultants that are specialist in their field. 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.

7. Going Forward

7.1 As the Council's capital strategy develops consideration will be given to criteria for performance and risk management to provide full due diligence for Non-Treasury Management investment.