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CAPITAL STRATEGY 2020 to 2024

Introduction

This strategy sets out the County Council's approach to compiling the capital programme, its priorities, availability of funding and financial management.

The County Council's capital programme is derived primarily from the Strategic Plan. It aligns with departmental commissioning and service plans to ensure a prioritised, joined up use of resources to maximise outcomes for all Leicestershire service users, citizens and other stakeholders.

This strategy links to the Medium Term Financial Strategy, the Corporate Asset Investment Fund (CAIF) Strategy and the Treasury Management Strategy. The CAIF Strategy sets out the Council's approach to non Treasury Management investments made primarily for the purpose of generating an income and supporting economic development. The level of funding available for the CAIF is determined by the Capital Strategy.

The overall approach to developing the capital programme is based upon the following key principles;

- To invest in priority areas of growth, including roads, infrastructure, economic growth, including forward the forward funding of projects;
- To invest in projects that generate a positive revenue return (spend to save);
- To invest in ways which support delivery of essential services;
- Passport Government capital grants received for key priorities for highways and education to those departments.
- Maximise the achievement of capital receipts.
- Maximise other sources of income such bids to the LLEP, section106 housing developer contributions and other external funding agencies.
- No or limited prudential borrowing (only if the returns exceed the borrowing costs).

Funding Sources

The approach to funding is:

External Funding
- Central Government Grants – passport grants to the relevant departments, even when not ring fenced.
- External Grants - maximise bids for funding from external sources including providing matched funding where appropriate to do so, subject to approval of fulfilment conditions and any contingent liabilities.
- External Contributions – maximise section 106 developer claims/ contributions to cover the full capital costs.

Discretionary Programme
- Capital Receipts – maximise individual receipts and use to fund the discretionary capital programme.
- Earmarked Capital Receipts – only to be used in situations where this is an unavoidable requirement of an external party, for example, there is a requirement to

gain DfE approval for the disposal of education assets, with the related receipts to be earmarked to education assets. These will be reviewed on a case by case basis to ensure the requirement is met and to consider options for substitution of discretionary funding where appropriate.

- Revenue underspends and surplus earmarked funds – review opportunities as they arise to contribute to the discretionary capital programme.
- Prudential borrowing – only to be used after all other available funding and only then where the incremental costs are fully funded from savings from the new investment. Internal borrowing (from County Council cash balances) would be prioritised over external borrowing.
- Leasing – Due to the County Council's ability to access relatively inexpensive funding rental/ lease proposals need to be appraised to ensure additional benefits justify the financing cost.

Other

- Renewal Earmarked Funds – held to make an annual contribution reflecting the life and replacement cost of the asset. Use when the service is externally funded (commercial, partnerships, specific grants) or small scale asset owned by an individual service. Larger more significant assets will be funded through the discretionary capital programme.
- Building Maintenance – funded through the Central Maintenance (revenue) Fund (CMF). Significant lifecycle replacements to be funded through the discretionary capital programme.
- Tax Incremental Financing (TIF) – investment repaid from additional income generated, for example additional Business Rates.

Capital Requirements

Children's and Family Services

Demand	£	Funding
Meet demand for new school places. Meet increasing demand for SEN places	High High	Central Government grants Developer contributions (section 106)
Maintenance and renewal for: Maintained school estate Children's Centres	 High Low	 Central Government grants Discretionary Programme
Children's social care (minimal demand as commissioned service)	Low	Spend to save

Adults and Communities

Demand	£	Funding
Records Office Adult Accommodation Strategy	High High	Discretionary programme Discretionary programme
Disabled Facilities Grant	Mid	Central Government grants
Maintenance and renewal for: Libraries & Heritage Community Libraries	 Low Low	 Discretionary programme Support external funding bids
Adult Social Care (minimal demand from commissioned service)	Low	Spend to save

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Public Health

Demand	£	Funding
Public Health (minimal demand from commissioned service)	Low	Spend to save

Environment and Transport

Demand	£	Funding
Maintenance of the highway infrastructure (using asset management principles) New Waste Transfer Station	High High	Central Government grants/ Discretionary programme Discretionary programme
Improvement to the highway infrastructure Major schemes Minor Schemes Advanced Design	 Mid Mid Mid	External Funding Central Gov't grants (inc. LLEP, TIF) Central Government grants Discretionary programme
County Council vehicle replacement programme	Mid	Discretionary programme
Maintenance and renewal of waste management infrastructure	Mid	Discretionary programme

Chief Executives

Demand	£	Funding
Economic Development (e.g. Broadband)	Mid	Central Government and External grants Discretionary programme (inc. TIF)
Programme of small shire community grants	Low	Discretionary programme
Other Services	Low	Spend to save, Discretionary programme

Corporate Resources

Demand	£	Funding
ICT Infrastructure Renew and expand the current corporate estate Major ICT upgrades and replacements	 Mid	 Discretionary programme Discretionary programme + Spend to save
Property Estate* Regulatory compliance Expansion and replacement	Mid	 Discretionary programme Spend to save
Commercial Services Replacement Expansion/Improvement	 Low	 Renewal reserve Spend to save
Transformation/change	Low	Spend to save

* maintenance of current properties funded from central maintenance fund (revenue budget)

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Corporate Programme

Demand	£	Funding
Corporate Asset Investment Fund	High	Spend to save
Deliver energy and water strategy	Mid	Spend to save

Future Developments Programme

Demand	£	Funding
Including: New Area Special School Children's Social Care Additional School and Highways Infrastructure (from housing growth) Adult Accommodation Strategy Collections Hub New Recycling and Household Waste Site Workspace Strategy Leics. Traded Servs Commercial Strategy Major ICT system replacements Corporate Asset Investment Fund Efficiency & Productivity Investment Fire Safety Contingency for major schemes	High	Discretionary Funding One off revenue and earmarked fund contributions Reinvest returns Spend to save

External Funding

To ensure that funding is at the required level the following approach will be taken.

Children and Family Services
Maximise DfE capital grant through up to date capacity assessments and school place data. Submit bids, where appropriate to do so, for additional DfE capital funding when available. Take opportunities to lobby the DfE for additional funding.

Adults and Communities
Work with District Councils and other partners to ensure that the Disabled Facilities Grant is at an appropriate level and how it is spent to reduce the costs of adult social care. Take opportunities to lobby the Department of Health for Social Care infrastructure grants.

Environment and Transport
Maintain Highways Infrastructure Asset Management Planning Level 3. Invest in advance design and business case development work focused on government priorities to access capital grants (which are increasingly being channelled through bidding processes) and developer funding.

Section 106 Contributions / Forward Funding
Maximise section 106 contributions through recovery of the total costs of required developments and regular review of key assumptions used (at least annually).
Where funding of capital expenditure is required in advance of the receipt of section 106 income (usually paid on completion of trigger points) projects may require initial cash flow by the County Council or from rescheduling grant expenditure.

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The County Council recognises the need to forward fund investment in infrastructure projects to enable new schools and roads to be built and unlock growth in Leicestershire before funding, mainly from section 106 developer contributions, is received. Forward funding of £28m for schools and £73m for highways has been included within the draft 2020-24 capital programme. When the expected developer contributions are received, they will be earmarked to the capital programme, to reduce the dependency on internal cash balances in the future.

Forward funding presents a significant financial commitment for the County Council, but should ensure:

- External funding is maximised, through successful bids.
- The final cost of infrastructure investment is reduced (compared with what it would be if construction was delivered incrementally as and when smaller developments come forward).
- The design is optimised, to benefit of the local community.

There are risks involved in managing and financing a programme of this size. There is reduced scope for funding additional schemes that are identified in the future. And an increased reliance on developer contributions through section 106 agreements means that it may take many years for investment to be repaid. This could be further compounded in the event of an economic slowdown. To this end, support of district councils is essential to ensure the agreements reached with developers mitigate these risks.

Tax Incremental Financing

The County Council will work with District Councils on construction schemes that unlock infrastructure and housing growth and seek agreements to fund the work from linked Council Tax, Business Rates growth and additional New Homes Bonus Scheme grant.

Summary

The 4 year capital programme 2020-24 totals £607m. External funding from capital grants, section 106 agreements and third party contributions totals £297m. Without this funding being available schemes of any significant size would not be affordable by the County Council.

Discretionary Funding

Discretionary capital programme totals £310m for the period 2020-24. Funding is from the sale of County Council capital assets (capital receipts), MTFS revenue contributions and surplus earmarked funds. Discretionary funding can also include prudential borrowing, which is unsupported by central government with the costs of financing the borrowing undertaken falling on the County Council’s revenue budget.

Capital receipts

Property Services are responsible for identifying additional capital receipts and maximising the sale value of surplus assets. Property Services will seek opportunities to maximise the value of surplus land, for instance by obtaining planning permission. The targets for new capital receipts to fund the 2020-24 capital programme, are:

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	General £m	Earmarked £m	Total £m
2020/21	-2.1	5.6	3.5
2021/22	8.3	-	8.3
2022/23	1.5	-	1.5
2023/24	2.5	-	2.5
Total	10.2	5.6	15.8

The target for 2020/21 has been adjusted by £6.5m to reflect timing delays in previous year's estimates. The estimates are higher in the earlier years reflecting the increased confidence in the sale of those assets.

Revenue Funding
The capital programme 2020-24 includes a total of £72m in revenue funding of capital.

On-going revenue - £1m is allocated in the MTFS.
One-off revenue - £71m is allocated in the MTFS/ earmarked funds. These have arisen from past:

- Opportunities from underspends – cannot be relied upon going forward.
- MTFS risk contingency
- Surplus earmarked funds no longer required

Other
For invest to save schemes, a discount rate of 6% will be used, including inflation, (3.5% for energy projects) as part of the net present value assessment in the business case. Only projects that show a positive return using these rates will be considered for inclusion in the capital programme.

Funding from Internal Balances
A total of £222m in funding required is included within the capital programme to fund the programme and enable investment in schools and highway infrastructure to be made. Over the next 10 to 15 years it is anticipated that circa £100m of this funding will be repaid through the associated section 106 developer contributions.

Due to the strength of the County Council's balance sheet, it is possible to use internal balances (cash balances) to fund the capital programme on a temporary basis instead of raising new loans. Levels of cash balances held by the Council, currently £260m, comprise the amounts held for earmarked funds, provisions, Minimum Revenue Provision (MRP) set aside for the repayment of debt, and working capital of the Council. The cost of raising of external loans currently exceeds the cost of interest lost on cash balances by circa 2.5%.

The overall cost of using internal balances to fund £222m of investment is estimated to be £8m per annum by 2024/25, comprising MRP of £6m and reduced interest from investments of £2m. This is a prudent assessment as the impact will reduce in future years as the funding is repaid.

The County Council's current level of external debt is £264m. As described above this is not anticipated to increase during the MTFS.

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Affordability

The impact of the discretionary programme on the revenue budget, and forecast at the end of the MTFS is:

£m	2017/18	2018/19	2019/20	2023/24
Revenue	1.7	0.7	0.7	1.2
MRP	10.8	10.4	10.0	9.7
Interest*	12.0	12.1	12.6	14.9
On-going revenue Total	**24.5**	**23.2**	**23.3**	**25.8**
% Revenue budget	7.0%	6.4%	6.2%	6.2%
Voluntary MRP	0.0	0.0	0.0	0.0
One-off revenue	16.1	27.8	75.0	1.0
One-off revenue	**16.1**	**27.8**	**75.0**	**1.0**
Total	**40.6**	**51.0**	**98.3**	**26.8**
% Revenue budget	11.7%	14.1%	26.1%	6.4%

*includes reduction in income received from transferred debt and interest cost of internal borrowing.

To ensure the discretionary programme remains affordable the following approach is taken to manage the MRP and interest charges:

- No new external borrowing to finance capital expenditure.
- Temporarily use internal balances from the overall council cash balances in advance of their designated use.
- Review opportunities to repay debt.
- Re-profile MRP in 2020/21 to be commensurate with the average age of assets funded from borrowing and delay the impact on the revenue budget. It should be noted that this does not reduce the amount to be set aside but simply delays the period over which it is to be paid.

Capital Financing Requirement

The CFR is the measure of the Council's historic need to borrow for capital purposes. As at 31st March 2020 the CFR is forecast to be £238m compared with actual debt of £264m. The difference is a temporary 'over-borrowed' position pending future scheduled debt repayments and new prudential borrowing requirements. The forecast cost of borrowing in 2020/21 is £19m rising to £25m per annum in financing costs (external interest and MRP) which is met from the revenue budget.

The planned use of internal cash balances to fund the four year capital programme will add £222m to the CFR. Together with reductions made by MRP, the CFR is forecast to be £432m by the end of the MTFS (31 March 2024). Assuming no new borrowing is undertaken in this period, actual debt would by £262m at that time, resulting in an under-borrowed position of £170m. This can be managed as interest charges of new debt is forecast to continue to be lower than the interest that can be earned on cash balances.

The detailed approach to this is covered in the Treasury Management Strategy, approved by the County Council annually in February.

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Financial Management of the Capital Programme

Prioritising the Programme

The approach to compiling the capital programme is through a combination of service requirements developed by each relevant department, statutory requirements and asset management planning.

For land and building assets, Strategic Property, in conjunction with service areas, develops all the estate strategies, asset management plans and property elements of the corporate capital and revenue programmes. They seek to ensure that the County Council is making full use of all assets, and any under-performing or surplus assets are identified and dealt with by either their disposal or investment to improve their usage. Outcomes from condition survey information together with on-going reviews of the property portfolio feed into the capital programme and revenue budget. The Corporate Asset Management Plan, which promotes the rationalisation of property assets, reducing running costs and cost effective procurement of property and property services is reported annually to the Cabinet.

The County Council operates the Corporate Asset Investment Fund (CAIF) which invests in assets to achieve both economic development and investment returns. A copy of the CAIF strategy is attached to the MTFS report. The CAIF operates through the Corporate Asset Investment Fund Strategy with a view to:

- Generate an income stream which increases the Council's financial resilience given the decrease in government funding
- Supports the delivery of front line services through increased income generation, or through capital investments that will reduce operating costs.
- Supports the Council's strategic objective of affordable and quality homes through helping to unlock and accelerate developments
- Manage investment risk by investing in diverse sectors
- Meet the objectives of the Council's Corporate Asset Management Plan, Strategic Plan, its Economic Growth Plan and the County-wide Local Industrial Strategy
- Maximise returns on Council owned property assets

Current holdings plus schemes in the 2019/20 and draft 2020-2024 capital programme will result in a total holding of £203m. A balance of £57m has been included for new asset investments to bring the fund to the notional target of achieving a holding of £260m. It is expected that this will be achieved within the next 5 years. Appraisal includes external due diligence performed before each purchase.

The corporate programme also includes additional funding of £60m for the Future Developments fund. The Fund is held to contribute towards schemes that have been identified but are not sufficiently detailed for inclusion in the capital programme at this time. There is a long list of projects that may require funding over the next 4 years. These include investment in infrastructure for schools and roads arising from increases in population, investment in health and social care service user accommodation, highways match funding of capital bids, and investment in the efficiency and productivity programme. The list of future developments is continually refreshed. Bids against the fund will be managed through prioritisation and where possible the identification of alternative funding sources. This approach forms part of the wider strategy to ensure that the capital programme is deliverable, affordable and the risks are understood, in line with CIPFA's requirements.

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For highways and associated infrastructure needs, the Council's key transport policy document is the Local Transport Plan. This provides the long term strategy within which the Council manages and maintains its network. In light of the continuing financial challenge the Council's priority is only to add to the highway network where this will help to enable new housing and jobs. Furthermore, additions will normally be considered only in circumstances where specific external funding can be secured to achieve this.

Further improvements to the highway network will require continued pursuit of external resources such as Government grants and developer funding. Government grants include bids to funds including Growth Fund (through the LLEP), the Growth and Housing Fund, the National Productivity Investment Fund, Local Authorities Majors Fund and the Housing Investment Fund. In order to maximise the impact of funding that can be secured for improvements, the County Council is doing more to define the roles of the various elements of the road network so that it is able to target investment where it will be of most benefit, particularly in terms of supporting economic prosperity and growth.

Bids for funding from the discretionary programme require the completion of a capital appraisal form for each project. The forms collate detailed information on the proposed project including justification against strategic outcomes, service objectives, statutory requirements and/or asset management planning, timelines, detailed costings including revenue consequences of the capital investment, and risks to delivery. All bids for land and building projects are also supplemented by a Strategic Property scoping and assessment form. Bids are then prioritised and assessed against the discretionary funding available. The revenue costs and savings associated with approved capital projects are included in the revenue budget.

Where schemes have not yet been fully developed these are included as future developments in the capital programme. As schemes are developed they are assessed against the available resources and included in the capital programme as appropriate.

Financial Management of Delivery

The key risks to the delivery of the capital programme are overspending against the approved budget, delays in the delivery of projects/programmes thereby delaying the expected benefits, and delays in or non-receipt of external contributions towards the cost of the scheme.

To ensure that capital spending and the delivery of this strategy is effectively managed:

- Programmes being reviewed in light of the most up to date information around funding available and latest priorities.
- All schemes within the programme being monitored regularly, usually monthly.
- Financial progress being reported on a regular basis throughout the year and at year end to the Cabinet and Scrutiny Commission to update them on progress and any significant variations in costs.
- Projects part or wholly funded by external contributions being separately monitored to ensure compliance with any funding conditions applicable.
- All projects are assigned a project manager appropriate to the scale of the scheme.

- The procurement of projects within the capital programme following the Council's approved contract procedure rules and where applicable the Public Contract's Regulations 2015.

Financial Indicators - CAIF

The Council has developed quantitative indicators to assess the total risk exposure as a result of its decisions. The indicators are based on statutory guidance on local government investments, and do not take account of Treasury Management investments unless these are expected to be held for more than 12 months, for example Private Debt.

The indicators and estimated positions for the current year and final year of the MTFS are shown below:

(CAIF Only)		Estimate* 2019/20	Estimate 2023/24
Debt to net service expenditure (NSE) ratio	Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.	0	0
Commercial income to NSE ratio	Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.	1.3%	2.3%
Investment cover ratio	The total net income from property investments, compared to the interest expense.	0	0
Loan to value ratio	The amount of debt compared to the total asset value.	0	0
Target income returns	Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties.	2.7%	3.7%
Benchmarking of returns (Revenue return plus Capital Growth)	As a measure against other investments and against other council's property portfolios.	CAIF 4.7% v 2.7% Pension Fund (Property Assets)	CAIF 5.7% v 4.3% LT Total Property Target
Gross and net income	The income received from the investment portfolio at a gross level and net level (less costs) over time.	Gross £8.2m Net £4.8m	Gross £14.6m Net £9.6m
Operating costs	The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.	£3.4m	£5.0m
Vacancy levels and Tenant exposures for non-financial investments	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.	12.5% (107,000 sq. ft)	7% (60,000 sq. ft)

*No borrowing has been incurred in respect of CAIF expenditure.